National Flag Shipping: An Analysis of Canadian Policy Proposals

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Centre for Transportation Studies
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Preface

In Canada, maritime interest groups have, for years, promoted measures to encourage the development of Canadian-flag shipping. Importers and exporters have opposed such measures.

Although studies have been carried out on particular aspects of Canadian shipping and many briefs have been presented to the Government, no independent policy analysis of industry proposals has been published. An opportunity exists, therefore, for a study from an independent source to identify and clarify key issues in the shipping policy debate. It is possible, also, that the analysis of Canadian policy proposals has relevance to other countries. This paper has been prepared with those purposes in mind.

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While I appreciate the wide and valuable assistance I have received during the study, I am solely responsible for the contents of the paper.

Trevor D. Heaver

Vancouver,
March, 1982

Chapter 1

INTRODUCTION

In spite of the volume and importance of Canadian international sea-borne trade, very few Canadian-registered vessels serve that trade. Federal Government policies have been accused of contributing to this situation. In the face of these criticisms and of changes in international shipping conditions, a number of studies on trade and shipping conditions were undertaken under the auspices of Transport Canada. The results of these studies are reflected in A Shipping Policy for Canada issued in January 1979 by the Honourable Otto Lang, then the Minister of Transport.

The report acknowledges that the changes that have occurred in shipping conditions require a policy of "more direct and active Government interest in deep-sea shipping matters..."[2] However, it concluded that no new financial or tax measures were warranted to encourage the development of a Canadian-registered fleet at that time, but that consideration would be given to the possibilities of Canadian-flag participation in the shipping of aid and certain commercial cargoes from Canada, especially from the Arctic. The full text of the policy statement is reproduced in Appendix 1.

In October 1979, during the term of the short-lived Conservative Government, Transport Canada issued a Background Paper on Deep-Sea Shipping.[3] The conclusions of this paper are similar to those contained in the report issued under Mr. Lang except for the conclusion that "in addition to steps to increase governmental competence and capacity in the shipping field, it would be desirable to put in place measures to encourage the gradual development of a Canadian deep-sea fleet".[4] It implies that selected tax and financial measures would place Canadian companies in a position comparable to that of foreign firms in exploiting opportunities in deep-sea shipping. But this policy was not adopted by the new Liberal

Government. In a speech before the Third National Marine Conference in May 1980, the Honourable Jean-Luc Pepin, then the Minister of Transport, indicated that the shipping policy was still under review. No new policy statement had been issued at the time of printing.

Throughout the period of policy review, marine interest groups and users (importers and exporters) have held opposing views on the desirability of using selected tax and financial measures to encourage the development of Canadian-flag deep-sea shipping. The users of shipping services argue that they have been and still are well served by foreign flag shipping. They fear that, in the long run, government-induced expansion of Canadian shipping would result in their paying higher taxes and/or shipping rates. Canadian marine interests argue that the Canadian-flag operations, which would develop under a more favourable shipping policy, would be competitive and would not require or even want subsidies. They argue that Canadian economic interests would be served by increased revenue and employment, and from the protection Canadian shipping would provide against the intervention of foreign governments in international shipping services. Discussions between user and marine interest groups have done little to resolve these differences of opinion.

Various tax and financial measures have been proposed by marine interest groups as appropriate means of encouraging the expansion of Candian deep-sea shipping. However, neither the industry briefs nor the Government reports have analyzed the consequences that particular tax or financial measures would have for the employment of Canadian resources. Consequently, the key question underlying the policy debate remains unanswered: would particular tax and/or financial measures designed to benefit Canadian-flag deep-sea shipping be an efficient use of Canadian resources?

This question is not answered here by quantitative analysis. However, an analysis of the policy options can identify those factors that determine whether or not such measures are likely to lead to an efficient use of resources. This is what I propose to do here.

In Chapter II, the general nature of international shipping services and the development of Canadian shipping policy are reviewed. In Chapter III, the various interest groups in Canada affected by the national shipping policy are described and their views summarized. In Chapter IV, the following questions are considered: whether the provision of specific tax and financial measures would enable Canadian shipping to expand and whether the measures would impose costs on other taxpayers. In Chapter V, the development of protectionist shipping policies by other countries is examined, and the implications for alternate Canadian policy measures are considered. In Chapter VI, the question is considered as to whether the economic benefits of Canadian-flag shipping would warrant subsidies to shipowners. In Chapter VII the special case of Arctic shipping is examined, and the conclusions of the paper are presented in Chapter VIII.

CHAPTER II

THE GENERAL FEATURES OF INTERNATIONAL SHIPPING AND CANADIAN SHIPPING POLICY

The effectiveness with which competition can be relied on to promote the efficient provision of services differs among sectors of the international shipping industry. Therefore, this chapter describes briefly the main types of shipping services available and the general regime of international law and government policies that have affected competition in shipping. This provides the background for reviewing the development of Canadian shipping policy.

Types of Shipping Services

There are two major types of shipping services: shipload services, which move goods in bulk for one or a few shippers; and liner services which carry relatively small shipments of general cargo for many shippers. The former service is comparable to a private or charter bus service; the latter, to an intercity coach line.

Shipload services

The vessels carrying shipload cargoes may be owned by importers or exporters, such as petroleum, steel, or chemical companies. But usually the vessels are chartered by the importers or exporters (as with a bus) from the shipowner. Under a time contract (time charter), the ship may be chartered for a few months or for years, sometimes for as long as the ship's economic life. Under a voyage contract (voyage charter), the vessel is made available for a trade for one voyage or a limited number of consecutive voyages.

The communication between shippers and shipowners for chartered shipping is world wide. Ships may shift their trading activity from one ocean to another and from one commodity to another as long as doing so is physically practical and economically advantageous. This mobility of ships is made possible by an international network of ship agents and brokers. Because of the excellent communication in this

market and the mobility of ships, economists may view this market as coming close to a competitive ideal. While this perspective is appropriate, the level of competition varies among the parts of the shipping market.

The very competitiveness of the market has led to the development of vessels designed especially to meet the cargo handling and carriage requirements of particular commodities and routes. The shape of holds, the size and type of hatch covers, and the details of cargo handling equipment are all important to operating competitively within a market segment. The reliability of an owner's operating record in terms of accidents, port delays, maintenance of sailing speeds throughout the period of a time charter and other factors, are also important. As a result, owners who may be at a competitive disadvantages in some respects, for example, wage rates, may still be able to find sectors of the market in which they can operate profitably.

The highly competitive nature of world bulk shipping markets does not mean that resources are always well used and that carriers regularly earn a "normal" profit. The stability of the market is greatly influenced by the fluctuations in demand over time, the predictability of those fluctuations, the rate at which supply can be adjusted over time and the foresight of shipowners about future demand. The traditional pattern of the boom and slump in ship charter markets indicates that many shippers and shipowners are poor forecasters and that shipping takes significant periods to adjust to new demand conditions. As a result, shippers and shipowners consider the timing of purchase and charter transactions to be of great importance.

Liner services

Vessels engaged in carrying general cargo for many customers provide liner service. To meet the needs of these trades, shipowners must commit vessels to a scheduled service over a largely predetermined route. On low-density routes one, two or three lines may provide service; on high density routes several lines may operate. The owners are generally free to transfer their vessels between routes, but the value of service reliability and continuity to shippers precludes the high short-run mobility of ships characteristic of the bulk market.

The nature of the competition faced by a few firms providing regularly scheduled shipping services has led to the voluntary formation of cartel-like conferences. Conferences are voluntary associations of liner firms providing service in one direction between ranges of ports; for example, the Trans-Pacific Freight Conference of Japan covers the route from South Korea and Japan to the U.S. west coast ports. Conferences claim to promote trade by providing efficient services at stable rates. They are designed to limit competition between member lines and to protect members from the competitive effects of non-conference liner services and chartered shipping.

Since their development in the 1860's, conferences have been the subject of investigations in many countries. In Canada, conference practices were considered most recently prior to the passage in 1979 of the revised Shipping Conference Exemption Act. The Canadian position is comparable to that of other countries: on balance, conferences have desirable effects, although the potential for abuse of monopoly power requires some government intervention. In Canada, the Shipping Conference Exemption Act constrains the practices of conferences and supports the principle of commercial negotiation of conferences with the Canadian Shipper's Council, as well as with individual shippers.

In some countries, particularly in less developed countries, the presence of a national-flag line is seen as one way to prevent the supposed abuse of monopoly power by foreign-controlled conferences. However, this view is not shared in Canada by shippers or carriers. They do not favour establishing a Canadian-flag line supported with subsidies for the purpose of influencing or monitoring the performance of shipping conferences. However, the changing commercial environment caused by the shipping policies of some other countries is one aspect of governmental influence in international shipping which is important to Canadian views on a national marine. Those developments are considered in Chapter V.

The International Mobility of Resources in Shipping

The competitiveness of the environment in which shipping services are offered is influenced by two important shipowner freedoms. First, they may establish shipping companies and register ships in a large number of countries. Second, they may, generally, offer services freely around the world.

The registration of ships

When a ship is registered in a country, it acquires the nationality of that country and becomes subject to its laws. The origins of registry policy can be traced back to the period of economic rivalry between the British and the Dutch in the seventeenth century. The protectionist or mercantilist policy of Britain required trade to be carried in British-built, owned and manned ships. Although the policy was formally abandoned with the repeal of the Navigation Acts in 1849, the rule of law by which ships possess the nationality of the country whose flag they are entitled to fly was well established and may be viewed now as a matter of legal expediency. Otherwise, ships and their crews would frequently be beyond the control of any government. Furthermore, each country has the right to establish such prerequisites for the assumption of its nationality as its concept of national welfare dictates.

The result is a system of ship registration which provides considerable freedom of choice to shipowners regarding the country in which their ships are registered, the nationality of the crew which they carry and the location of controlling management. "Flags of convenience", or, "open" registries, which provide a favourable haven

for shipowners faced with less favourable conditions for ship registry in their native country, have a very long history.[5] However, they have become particularly significant since World War II due to the rapid growth of world shipping and high rates of taxation in most countries.

Exhibit I shows the size of the flag of convenience fleets and other major flag fleets between 1949 and 1980. The dramatic growth of the Liberian fleet during the 1950's was caused largely by the registration of U.S.- and Greek-owned vessels. The share of the world fleet registered in flag of convenience countries continued to increase until the late 1970's when it stabilized as the growth of the world fleet, particularly tankers, slowed and as the relative differences between the conditions for operating ships under the various registries lessened.

One of the important characteristics of the registration of ships and the location of controlling management is their sensitivity to the economic climate. A recent study of changes in vessel registry by the OECD concludes as follows:

> Overall during the two years under examination [1978 and 1979] 41.4 million grt (69.2 million dwt) moved from one flag to another, more than 10 per cent of the entire world fleet. This continual flow of both ship sale and transfer of flag without change of ownership is a vital element in the flexibility of the world shipping system and the erection of barriers to this movement can but obstruct the rationalisation of ship operation under the flag where, [sic] in the particular circumstances of the trade concerned, it is most economic use.[6]

The international mobility of resources in the shipping business is highly distinctive. A result is that governments interested in maintaining or developing a national-flag deep-sea fleet must ensure that the conditions associated with registry under their flag are commercially attractive. The responses of Canada and selected other countries to this situation are considered in Chapter IV.

The freedom of shipping services to enter trades

Prior to the mid-1960's, shipowners generally enjoyed the ability to offer their services freely around the world. Free access to ports was available in most countries and this was coupled with relative freedom of shippers to enter into contracts of carriage with shipowners, irrespective of the nature of the cargo or flag of the vessel employed. The system favoured the efficient use of shipping capacity, enabled the rapid expansion of well-managed fleets, and was a favourable environment for importers and exporters, who had a wide choice of services. Canada has endorsed the system in Note 1 of the OECD Invisibles Code.[7]

The freedom of shipping services to enter trades has changed over

EXHIBIT 1

Composition of the World Fleet by Country of Registry, 1949-1980
(millions gross registered tons)

Country of Registry	1949	1955	1960	1970	1980
Liberia	--	4.0	11.3	29.4	76.8
Panama	3.0	3.9	4.2	5.7	21.3
Other Flag-of-Convenience	0.4	0.8	0.2	1.4	11.3
Total Flag-of-Convenience	3.4	8.7	15.7	36.5	109.4
Japan	1.6	3.7	6.9	23.5	37.8
Greece	1.3	1.2	4.5	10.2	35.1
U.K.	18.1	19.4	21.1	23.7	25.7
Norway	4.9	7.2	11.2	19.0	22.1
USSR	2.1	2.5	3.4	10.8	17.1
U.S.A., sea fleet only	25.6	23.9	22.3	17.5	15.5
World Fleet	83.3	100.6	129.8	204.9	381.0
Canada, sea fleet only	1.4	0.59	0.55	0.77	0.96

Sources: Lloyd's Register of Shipping for 1949-1960; Bremen Institute of Shipping for 1970 and 1980.

the last fifteen years, particularly as a result of the concerns and aspirations of the developing countries. Some developing countries have promoted the idea of reserving a part of their trade for their national lines. They have promoted the concept in the Committee on Shipping of the United Nations Conference on Trade and Development (UNCTAD) and, in some cases, they have acted unilaterally to ensure the carriage of a certain amount of their trade on nationally registered ships. Canadian shippers, carriers and the Government acknowledge that these developments necessitate some changes to the long-standing laissez-faire policy of Canada. The implications for Canadian shipping policy are considered in Chapter V.

Shipping in Canadian Economic History

Shipping services have always been an economic lifeline for Canadians. For the first settlers, ships were the source of essential supplies from Britain and provided the means by which furs and agricultural, forestry and mining products, could be marketed. Up to the First World War, the availability of shipping services posed no problem for the developing colonies or country. (Of course, the long distances faced by Western Canada were a problem.) Sailing distances were favourable compared with other parts of the New World, services were available on a competitive basis and Canadian enterprises were successful in the development of shipping services. In Eastern Canada, especially in the Maritimes, a maritime tradition grew up based on shipbuilding, fishing and trade.

In 1840, Samuel Cunard of Halifax established a transoceanic service that developed into a world famous line; and by 1878, Canada ranked fourth among the shipowning nations of the world.[8] However, in the last decades of the century, Canadian participation in shipbuilding and shipping diminished as steel and engineering skills, which Canada lacked, became prerequisites for a successful shipbuilding industry.

Canadian concerns with transportation became preoccupied with internal transportation problems: constructing roads, improving the navigability of the St. Lawrence and, above all, developing an efficient east-west railway system. Government intervention in these internal transportation systems, not intervention in the provision of international shipping services, was the key to population settlement and economic growth. By 1914, the only Canadian companies providing regular deep-sea services were the Canadian Northern Railway, the Canadian Pacific Railway, and William Thompson of Saint John, N.B., which had a service to the Caribbean.

In the First World War, Canadian shipyards became active again, at first, as a result of British orders. In late 1917, the Federal Government decided to build and operate ships under a Crown corporation known as the Canadian Government Merchant Marine. The undertaking proved to be a calamitous financial venture because of the high cost of the ships and the depressed shipping market. The last ships were sold in 1936.[9] Throughout the inter-war period a Canadian

shipping presence continued to be evident in the services of Canadian Pacific Steamships Limited, based in London from 1915, and Canadian National Steamships.[10]

The Second World War revived urgent demands on the Canadian shipbuilding industry; at its wartime peak, it employed about 100,000 persons. Of the merchant ships built, 71 percent (258 ships) were owned by the Government and operated through a new Crown corporation, Park Steamships. At the end of the war, the Government chose to sell off the ships to avoid a repetition of the experience of the 1920's. The Government originally intended for most of the ships to be operated as Canadian vessels. But because these ships which were operated under the Canadian registry were unprofitable, the Government agreed to the sale and/or off-shore registry of the ships.

The last regular deep-sea service in the immediate post-war period was provided by Canadian National's West Indies Service. After losses from 1949 through 1955, the company showed a small profit in 1956. But a strike in 1957 could not be resolved. The vessels were sold to Cuba and the company was wound up in 1959.

The Government was unwilling to provide the substantial subsidies necessary to keep in regular deep-sea service ships registered in Canada and employing Canadian crews. Consequently, the percentage of Canadian overseas trade carried on vessels registered in Canada declined from about 23 percent in 1947[11] to a fraction of one per cent in 1976.[12]

Canadian shipping policy relied heavily on the British Merchant Shipping Act of 1894 until 1936 when the Canada Shipping Act was proclaimed. However, it was not until the Canada Shipping Act of 1950 that vessels registered in Canada were referred to as "Canadian" rather than "British" vessels. Even then, Canada was a party to the British Commonwealth Merchant Shipping Agreement of 1931, which implied that all ships registered in Commonwealth countries would have equal access to the member states' international trade as British ships.

The close economic and cultural ties with Britain are part of the explanation for Canada's adherence to a laissez-faire shipping policy. But the major explanation is that the policy has served Canada's commercial trade requirements well. However, the pressure for a change in Government policy with respect to deep-sea shipping has become more strident in the last decade.

CHAPTER III

THE COMPOSITION AND VIEWS OF INTEREST GROUPS

To date no consensus has been reached about the desirability of tax and/or other financial measures to encourage the registration of deep-sea ships in Canada. The divergent views of the interest groups can be explained, in part, by their particular interests in international shipping. This chapter describes the composition and views of major interest groups. Later chapters evaluate the views and consider the potential importance of the interest groups' positions in the choice between policy options.

Four major special interest groups can be identified: shipowners, seafarers, shipbuilders and shippers (importers and exporters). This classification distinguishes between corporate and union interests in shipping, but not in shipbuilding. The interests of taxpayers in general, must also be recognized. While classifying interest groups is useful to capture the essence of different positions, it does not imply that each groups has a homogeneous view. Indeed, the heterogeneity of interests within each group is an important complicating factor in the dialogue about desirable changes in government shipping policy.

The Interests of Shipowners

The interests of shipowners are highly diversified because of the varied components of the shipping business in which they are engaged. Even firms engaged in similar shipping businesses are probably giving different emphasis to particular submarkets; they are not in exactly the same business and so their viewpoints are not identical. Therefore, before presenting the views of shipowners, it is necessary to identify the major components of the industry.

Major groups of shipowners

The industry can be subdivided according to the associations into which shipowners are organized. However, since some major shipowners do not belong to Canadian shipowners' associations, their interests must be identified separately.

The Council of Marine Carriers. The Council is located in Vancouver and represents mainly B.C. towing companies. Several of these companies are subsidiaries of forest companies and are engaged largely in servicing that industry. Some of the companies, for example, Seaspan, a subsidiary of Genstar Ltd., have engaged in international work.

The Dominion Marine Association (DMA). The DMA is composed of the largest domestic shipping companies in Canada, which are engaged primarily in Great Lakes trades. (See Darling and Shaw for a good summary of their activities.[13]) Each of the twenty member companies has a distinctive mix of interests. Some of the members are petroleum companies; others are significantly involved in the movement of oil; still others have specialized in the movement of the dry bulk cargoes, grain, iron ore and coal, which dominate the Great Lakes trade. The firms with over 100,000 gross registered tons in 1979 were Canada Steamship Lines, Upper Lakes Shipping, Algoma Central Railway, Halco, Scott Misener Steamships, and N.M. Patterson & Sons. The President of the DMA, Rear Admiral R.W. Timbrell, RCN (Ret) and executives of some of the member companies, have been the most visible advocates of a Canadian deep-sea fleet.

The St. Lawrence Shipowners' Association and the Newfoundland Shipowners' Association. The St. Lawrence Shipowners' Association has more member companies than the DMA, but the companies are much smaller and are engaged in a diversity of trades in the St. Lawrence and the Maritimes. The Newfoundland Shipowners' Association has about the same number of member companies as the DMA, but they too are relatively small. Some member companies were created largely to carry the products of parent companies. Others are primarily 'for hire' companies. The interests of some of the companies are influenced by the interaction between coastal and deep-sea international services.

Canadian Shipowners' Association (CSA). This Association of domestic shipowners has recently been reactivated. It is composed of owners with at least one vessel with deep-sea capability. With the exception of DMA members who do not meet that requirement, and with the addition of CN Marine of Moncton, N.B. and Clark Transport Canada Inc. of Montreal, the CSA membership parallels that of the DMA. There are, however, several Canadian resident shipping firms that own deep-sea vessels, as well as firms with off-shore shipping subsid'aries, that do not belong to the CSA.

The Shipping Federation of Canada. The interests of foreign shipowners who provide service to eastern Canada are represented through the Shipping Federation of Canada. Their interests are consistent with the Government view that relying, as much as possible, on laissez-faire is desirable.[14] The Federation has not been vocal in its support of this, nor has it needed to be, since the view has been well articulated by various Canadian interest groups. The position of the Federation is not considered further in this chapter. (It should be noted that Canadian shipowners have not criticized foreign, privately owned lines. Rather, they wish that the Government would

create an environment in which Canadian firms, with Canadian-registered ships, could compete with them effectively.

Other Canadian Shipowners. Some Canadian firms directly involved in deep-sea shipping are not members of any of the above associations. These are considered here. (The involvement in shipping interests by some shippers, for example, the forest industry firms, is considered under the interests of shippers.)

Saguenay Shipping Ltd., a wholly owned Canadian subsidiary of Alcan Aluminum Ltd., is the largest Canadian-domiciled corporation providing an international liner service. Its operations are between Canada, the Caribbean, Venezuela and Columbia. It employs mainly chartered rather than owned tonnage, including two Canadian-flag vessels on time charter from Quebec-based Boreal Navigation Inc. Important to Saguenay's operations is the advantage which it has in meeting the requirements of its parent company for northbound movement of bauxite and aluminum from the Caribbean and, more recently, its position as a Canadian carrier in the Colombia and Venezuela trades, in which flag-preference policies are being imposed. Alcan's subsidiary services between the Caribbean and the UK are provided by Saguenay Shipping (UK) Limited.

The services of Saguenay are noteworthy because they are managed by a Canadian corporation from within Canada. However, until the time chartering of the Canadian-flag Sunemerillon in 1978, Saguenay, like most other Canadian companies with an established presence in for-hire, deep-sea shipping, operated with foreign-flag vessels. As a Canadian-domiciled company, Saguenay is subject to Canadian tax laws.

Canadian Pacific Ltd. owns and operates a substantial fleet of deep-sea ships through foreign subsidiaries, namely Canadian Pacific Steamships Ltd. of London, founded in 1915, and Canadian Pacific (Bermuda) Ltd., founded in 1965. Vessels have been registered in Britain, Hong Kong and Bermuda, although, during 1980, vessels were transferred from the Bermuda flag. The operations include trans-Atlantic container service and worldwide charter operations in the crude oil tanker, the products tanker and dry bulk trades. Some of the first bulk ships of CP (Bermuda) Ltd. were designed especially for long-term charter to MacMillan Bloedel for employment in the British Columbia/United Kingdom forest products trade.

The second largest Canadian-owned fleet of deep-sea vessels is that of the Cast group of shipping companies, owned by EuroCanadian Shipholding Ltd. of Switzerland. The company, headed by Mr. Frank Narby, a Canadian citizen living in Switzerland, is owned 61 percent by Dolphin Investments (Narby), 21 percent by Helix Investments of Toronto and 18 per cent by Canadian National Railways. Cast, like CP, operates a trans-Atlantic container service as well as diversified charter operations. Its fleet has been characterized by a significant number of combination ore-bulk-oil vessels (OBO's). A $165 million multiple vessel acquisition in 1980 was reported to make Cast the largest single owner of OBO's in the world.[15] The company had severe

financial problems in 1981.

The final large shipping company that is not a member of a Canadian shipowners' association is Papachristidis Marine Inc. The company commenced shipping in Canada with vessels acquired from Park Steamships.[16] Later the company acquired Great Lakes bulk carriers; these were sold to Upper Lakes Shipping Ltd. of Toronto in 1972 at a time of changing commodity movements. The company then increased its ownership of foreign-flag deep-sea ships. It has generally acquired vessels for deployment on long-term charters. This method of contracting can assist financing, provides financial stability and allows the company to protect steady cash flows from income tax with interest charges and extended depreciation. The company owns vessels directly in Canadian companies, although it has acquired some vessels through foreign subsidiaries.[17] Early in 1982, the company established a new subsidiary to control some of its operations from England.

The Canadian-Owned Deep-Sea Fleet

The extent to which Canadian-controlled firms participate in international deep-sea shipping is impossible to measure in quantitative terms because of the diversity of their interests. However, the ownership of vessels capable of deep-sea operation and the employment of those vessels in international trade is limited to a few companies.

K.C. Griffin has provided an excellent summary of the characteristics of the Canadian deep-sea fleet.[18] He has documented all vessels capable of operating deep sea which are beneficially owned by Canadians. The vessels include those that are wholly or largely operating in Canadian domestic trades, and those that are owned, registered and managed through foreign subsidiary companies.

Exhibit 2 shows that the estimated total size of the Canadian-owned deep-sea fleet has grown from 2.6 to 7.1 million deadweight tons between 1973 and 1980. Of this fleet the percentage registered in Canada has declined from 18 to 13 per cent, although the size of the Canadian-flag fleet has nearly doubled. The foreign-flag vessels are involved in international deep-sea trade and are a clear indication of the significant presence of Canadian-owned ships in world trade. The vessels shown as operating under the British flag come under a number of financial regimes, since countries such as Bermuda and Hong Kong use the British flag. This tabulation cannot be used, therefore, to measure the amount of shipping registered under flag-of-convenience conditions.

Exhibit 3 shows the estimated composition of the fleet by shipowner. Canadian Pacific Ltd. (CP) and the Cast group of companies are the major owners. The operations of these companies and of Papachristidis Marine Inc. have already been described. The operations of other companies are described briefly here in order to reveal their wide diversity of activities.

Fednav Ltd. controls a number of subsidiaries including Federal Commerce and Navigation (which is a member of the DMA and CSA). Federal Commerce and Navigation was founded in Toronto in 1944 and developed its shipping business based on the Great Lakes.[19] Its early search for European cargoes to match with bulk exports from the Great Lakes soon led the company into deep-sea operations. The Fednav group of companies now controls diverse operations: bulk carriers, including several specially designed with sea-going capability while conforming to Seaway dimensions; specialized roll-on roll-off vessels (Ro-Ro's) employed in the east coast transatlantic paper and car trades;[20] liner services out of the Great Lakes;[21] and tug and barge and off-shore supply operations.

Other companies active in the Great Lakes have limited involvement in deep-sea operations. Upper Lakes Shipping has enjoyed success with two self-unloading deep-sea carriers that carry a variety of cargoes, mainly in North American east coast trades. The self-unloading bulk carrier system was developed first in the Great Lakes trade. The specialized nature of the trades and of the vessels has enabled Upper Lakes Shipping to operate profitably with Canadian-flag vessels.[22] The potential of bulk carriers built to Seaway dimensions and with deep-sea capability in ocean trades on a seasonal or longer basis has led Canada Steamship Lines and Algoma Central Railway to acquire such vessels.

Hall Corporation operates a fleet of small product tankers mainly in domestic trades. In 1980, the company commenced operating a Liberian-flag tanker with a Canadian crew in international trade. Several of the owners of deep-sea vessels specialize in tanker trades (for example, Branch Lines, Imperial Oil, Kent Line and Jason Steamship) for supply and/or distribution to Canadian ports. Rayship Canada owns foreign-flag bulk carriers that serve the smelter of its parent company, Canadian Reynolds Metals, at Baie Comeau, Quebec.

These firms not only engage in widely diverse activities, they are, also, of different sizes and financial structures. The significance of shipping--or even transportation--varies in the corporate structure. It is not surprising, then, that views on appropriate policy measures differ from one firm to another. It follows, also, that any policy, whether existing or yet to be introduced, cannot provide all companies with the same advantages--or disadvantages.

Views of Shipowners

Arguments on the benefits of more Canadian-flag shipping and the

means to bring it into being have a long history. The particular means recommended have varied among spokesmen and over time. Proposals have included the payment of subsidies,[23] and some measures of cargo reservations beyond coastal trades, including the development of bilateral arrangements with Canada's main trading partners.[24] Shipowners are still not unanimous in their views. The variety of positions expressed over time has contributed to uncertainty, particularly on the part of importers and exporters, about the real purpose of the shipowners' position.

This review of the shipowners' position regarding Canadian-flag shipping restricts itself as far as possible to briefs released in or after 1978 and to views expressed to the author in interviews in 1980. The positions of the shipowners are divided into four groups according to whether they deal with the general marine policy posture of the Government, its shipbuilding policy, market protection and expansion measures, or financial policy concerns affecting deep-sea shipping.

The general marine policy posture of the Government. Shipowners feel that 'the Government in Ottawa does not know and does not care'. This is not to deny that a few politicians and some civil servants are both well informed and have clear policy positions. But, on the whole, shipowners feel that the Government does not understand marine affairs and that the result is delayed or wrong action.

In a joint brief of the four regional associations of Canadian shipowners in 1978 (hereafter, referred to as the joint brief), shipowners were critical of the functioning of the Shipping Advisory Board, a Government interdepartmental committee formed to facilitate the discussion of marine issues and, thereby, the development of shipping policy.[25] The associations sought to ensure greater input to the Government from industry and labour to provide "the necessary background and atmosphere".[26]

Shipowners have also been critical of safety standards. In 1978, Mr. W.A. O'Neil, Commissioner of the Canadian Coast Guard, reported on discussions and progress that had been made since the first national marine conference.[27] In general, shipowners stress that Canadian requirements are excessive by international standards, although accident investigators have recommended higher standards in certain areas.[28] Shipowners claim that operating a foreign-flag vessel under waiver in coastal trades has advantages over importing the vessel and incurring significant costs for modifications.

Shipowners consider the inspection procedures of the Ship Safety Branch (formerly the Canadian Steamship Inspection Service) of the Canadian Coast Guard to be unnecessarily duplicative of inspections by classification societies. They argue that their costs and those of the Government might be held down if procedures, which they claim are used effectively in the UK, were applied here. Shipowners believe that more progress should have been made towards making the operation of Canadian-flag vessels more cost-competitive. They point out that

EXHIBIT 2

Composition of the Canadian-Owned Deep-Sea Fleet
By Flag of Registry, 1973, 1980[a]

Flag	1973 000 dwt	1973 %	1980 000 dwt	1980 %
British	1,445	55	4,919	69
Canadian	478	18	900	13
Liberian	575	22	831	12
Belgian	67	3	173	2
Greek	--	--	165	2
New Zealand	--	--	83	1
Singapore	--	--	40	--
Panama	43	2	23	--
Norwegian	--	--	10	--
Total[b]	2,609	100	7,143	100

Notes: a. Vessels of which the beneficial ownership was Canadian in 1973 and 1980.

b. Totals may not add due to rounding.

SOURCES: For 1973: K.C. Griffin, "Canada's Deep Sea Fleet is Hidden Offshore," Seaports and Shipping World, February, 1979; 1980 data based on K.C. Griffin, "Composition of the Canadian Deep Sea Fleet 1980," Unpublished, January, 1981.

EXHIBIT 3

Composition of the Canadian-Owned Deep-Sea Fleet
By Major Shipowner, 1973, 1980[a]

Company[b]	000 dwt	%	000 dwt	%
Canadian Pacific Ltd.	969	37	2,446	34
Cast Ship Services Ltd.	--	--	2,167	30
Fednav Ltd.	238	9	519	7
Papachristidis Marine Inc.	76	3	472	7
Kent Line Ltd.	115	4	183	2
Upper Lakes Shipping Ltd.	148	6	176	2
Jason Steamship Co. Ltd.	251	10	151	2
Rayship Canada Ltd.	126	5	126	2
Canada Steamship Lines Inc.	41	2	122	2
Halco Inc.	59	2	98	1
Imperial Oil Ltd.	196	7	55	--
Others	391	15	626	9
Total[c]	2,609	100	7,143	100

Notes: a. Vessels of which the beneficial ownership was Canadian in 1973 and 1980.

b. Companies listed by common Canadian names of controlling interest in 1980. Companies listed are those with more than 1% of the fleet in 1980, plus Imperial Oil Ltd.

c. Totals may not add due to rounding.

SOURCES: For 1973: K.C. Griffin, "Canada's Deep Sea Fleet is Hidden Offshore," Seaports and Shipping World, February, 1979; 1980 data based on K.C. Griffin, "Composition of the Canadian Deep Sea Fleet 1980," Unpublished, January, 1981.

this would have been aided, also, by exempting from pilotage service, vessels with Canadian officers which ply a route regularly.[29]

The separation of shipping from shipbuilding policy. For many years, arguments about the desirability of a greater Canadian presence in shipping have linked the capability to build ships with the control of their operations. In the joint brief, shipowners' associations recommended shipbuilding subsidies in order to keep Canadian shipyards competitive with foreign competition.[30] In July 1979, the Dominion Marine Association recommended that for a period of at least five years, shipowners be free to acquire their vessels overseas without the loss of any benefits from measures introduced to encourage Canadian deep-sea shipping.[31] Since that time the majority of shipowners have adopted the position that deep-sea shipping policy should be distinct from shipbuilding policy. In May, 1980, Mr. T. Norman Hall, the Chairman of the Canadian Shipowners' Association, stated that it is necessary to have "the freedom to obtain vessels anywhere and have them treated as Canadian sources."[32] Mr. Paul E. Martin, President of Canadian Steamships Ltd. (CSL), which owns two shipyards as well as a shipping fleet, expressed the view as follows:

> I think that we must make a clear distinction between shipbuilding and ship operations. The Canadian shipbuilding industry faces a unique set of problems which arises from the tremendous amount of government financial support given to shipyards in Europe and Asia. ...Although I consider Canada's policies concerning the shipbuilding industry to be important, this area is properly the concern of our industrial policy, not our transportation policy. It goes without saying that Canada's shipowners would prefer to use Canadian built ships. However, shipowners could not accept this if it would put us at a competitive disadvantage compared to companies operating ships obtained from lower cost, heavily subsidized foreign shipyards. Thus, an important element of our proposal to become competitive in deep sea shipping is that Canada's shipowners must be allowed to obtain vessels at world competitive prices.[33]

Market protection and expansion measures. In the 1978 joint brief, shipowners recommended a number of policies aimed at protecting or expanding the markets they could serve.[34] They supported the restriction of Canadian-flag vessel ownership to firms "controlled" by Canadian citizens, with the exception of existing foreign-owned firms. This would ensure the dominance of Canadian firms in domestic shipping markets, if those markets were closed to Commonwealth shipping except under waivers. They also recommended selective bilateral shipping agreements with other countries and more emphasis on achieving terms of shipment giving Canadians control of shipping arrangements. In 1980, Mr. L.G. Pathy, the President of Fednav Ltd., suggested that "we should encourage and solicit Canadian exporting companies and, for that matter, the Canadian government to sell their commodities on a CIF basis".[35]

These arguments have given rise to concerns among shippers of possible intervention in their trading terms. Their uncertainty has led shipowners to emphasize an important foundation of their argument: "that Canadian ship operators must be competitive with foreign operations."[36] "We must, above all, be careful in identifying those areas where Canadian-flag ships can be naturally competitive."[37]

The joint brief also recommended that research and development programs on a joint-venture basis be undertaken to advance technology for the Arctic and that technical training for marine employees be improved and extended.

Financial measures. The main interest of shipowners is in tax allowance and financing measures that would give Canadian-flag operators a chance to be competitive in international shipping markets. In 1979, the DMA reviewed and updated its statement of financial measures needed to stimulate the development of Canadian-flag deep-sea fleet.[38] They were as follows:

- Personal income tax concessions on remuneration earned while on a deep-sea voyage, thereby lowering labour costs. The result would not be labour rates competitive with Asian crews but "perhaps...with those of most Western European flag carriers".[39]

- The availabilty of low interest loans similar to those given by the EDC.

- The availability of the Investment Tax Credit.

- The allowance of 100 per cent capital cost allowance at any time, chargeable to "marine operations" to the extent that vessels are "engaged in foreign-going trades."[38]

- An extra capital cost allowance of 20 per cent, available at the rate of 5 per cent in any year.

- The allowance of tax-free reserve funds for vessel replacement within a five-year period.

- The application of the incentives to foreign- as well as Canadian-built ships for a period of at least five years.

The various measures are simply listed without any indication of priority. This may reflect the fact that the impact of the measures would differ among firms, particularly with the size of their annual net income. Firms with substantial profits to protect would find large capital cost allowances most attractive; others would find financing assistance measures preferable. The measures differ from those requested in the joint brief of 1978: leveraged lease financing is not mentioned; while tax allowances for crews and the extra capital cost allowances are additions.

The general position expressed to the Federal Government through the associations has been supported widely by individual shipowners, including those now operating through offshore companies. In 1978, Mr. Frank Narby argued that it must be made "convenient for Canadians to own ships and register them under the Canadian flag."[40] In 1980, Mr. L.G. Pathy, President, Federal Commerce and Navigation Ltd., argued in favour of a policy environment in Canada comparable to that in many other western countries so that Canadian shipowners could develop services "where Canadian-manned ships can be competitive internationally."[41] Of the major Canadian shipowners, only CP Ltd. has not made public its views on measures to encourage Canadian-flag shipping. However, in 1965, the company expressed dissatisfaction with a federal taxation policy that put beyond doubt the necessity of investing in international shipping offshore rather than in Canada.

Shipowners have made three arguments supporting the need for a new Government policy. The first argument is that economic benefits would accrue to the country in terms of employment and balance of payments. These advantages have not been stressed over the last two years.

The second argument, 'the dark clouds argument', is that erosion of the competitive environment of international shipping will, sooner or later, force Canada to have a greater presence with Canadian-flag vessels in international trade. This argument is developed more fully in Chapter V.

The third argument is that measures to encourage Canadian-flag shipping are more appropriate now because of the change in the cost structure of shipping such that Canadian-flag operators need not inherently be at a commercial disadvantage. This is accounted for by the more capital-intensive nature of ships, the reduction of crew sizes, the lower level of wage inflation in Canada than in Japan and some European countries, and the rise of fuel costs. Not only are wage costs a declining percentage of total ship operating costs, but the cost difference of Canadian compared with northwestern European crews has been held to be small. The case for tax concessions and other measures to enable Canadian shipping to compete internationally on equal terms with foreign companies, the "equal opportunity argument", is considered in Chapter IV.

Summary

Shipowners argue that the benefits of a Canadian-flag presence in international shipping are increasing and that a gradual development of deep-sea shipping is the most efficient response. They argue, as well, that as long as the financial environment created by the Government is comparable to that of other maritime nations, a Canadian presence is also practical because of the greatly decreased significance of the crew cost disadvantage. Shipowners stress that other regulatory measures and the role of labour are important, as highlighted in the following statement of the DMA:

However, even with the financial measures requested, it is of the utmost importance that a totally dedicated co-operative spirit be maintained between the industry and all departments of Government responsible for any new aspect of marine operations, together with labour, if success in this new venture are to be achieved. Examples of areas where this approach must be followed are in the operation of ports and their services, the Seaway, pilotage, environmental regulations, manning levels, ship surveys, issuance of Transport licenses and the carriage of foreign-aid cargoes.[42]

The Interests of Labour

The availability, cost and quality of labour are crucial to the development of a Canadian deep-sea fleet. The interests of labour are represented by a number of unions, listed in Exhibit 4.

EXHIBIT 4

Canadian Maritime Unions

Officers	Seamen
Canadian Maritime Union (CBRTEW)	
Association Des Officiers du St. Laurent	Canadian Maritime Union (CBRTGW)
Canadian Marine Officers Union	Seafarers' International Union
United Steel Workers of America	United Steel Workers of America

The unions have consistently supported and promoted measures to enable and encourage the expansion of Canadian-flag shipping. They support the arguments and proposals of shipowners except for the proposal that deep-sea crews be granted tax concessions. They do not like the differential ("second class") treatment of deep-sea compared with coastal crews, and they do not wish the security of their remuneration to become dependent on Government tax policy.[43]

A paper by the Seafarers' International Union (SIU) elaborates on the views of the largest of the unions.[44] In addition to supporting the type of financial measures proposed by shipowners (except for the crew tax concession), the SIU recommends that bilateral trading agreements be developed so that Canadian trade is carried in Canadian-flag ships and the "UNCTAD level of 40%, 40%, 20% is reached."[45] The basic rationale is that it would be better for "Canadians to enjoy the financial benefit of Canadian industrial growth than no benefit by using a foreign shipping service operating to and from Canada."[46] A total of 40,000 jobs is anticipated to result from creating a deep-sea fleet. The presence of a Canadian-flag fleet is seen, also, as a means of providing national security.

The unions acknowledge that labour supply has been a problem.

Although there are areas of unemployment, a shortage of qualified officers exists. In addition, the need for improved training for seamen is anticipated. This is reflected in the continued emphasis that has been given to improving training facilities and in the efforts of industry, government and labour in the National Advisory Council on Marine Training. For unlicensed personnel, the SIU, with industry financial support, has established a training school at Morrisburg (Ontario). For licensed personnel, initial training combines academic and sea experience and is available at St. John's (Newfoundland), Rimouski (Quebec) and Owen Sound (Ontario), with similar facilities planned for Halifax and Vancouver. Upgrading is available at provincial schools in St. John's, Halifax, Quebec City, Montreal, Owen Sound and Vancouver. In spite of these efforts, the availability of adequately trained and experienced labour for deep-sea operations is uncertain.

The Interests of Shipbuilders

The major Canadian shipyards and fifty-three affiliated firms are members of the Canadian Shipbuilding and Ship Repairing Association (CSSRA).[47] The CSSRA was formed in 1944 to preserve, maintain and develop the shipbuilding and repairing industries and for the "advancement of the industrial, technical, economic, social, defence and sovereign interests of Canada."[48]

The CSSRA supports the development of a Canadian deep-sea fleet, but they "do not ask that the ships be built in Canada."[49] In its brief of July 1979, the CSSRA also supported "tax policies to permit 'pre-tax' dollars to be spent on vessel replacement and [the availability of] low-interest loans to Canadian shipowners."[50] In a subsequent brief in September 1980, the CSSRA makes more specific recommendations.[51] The Association recommends that the investment tax credit (basic rate of 7 percent) be limited to Canadian-built ships; that lease financing be re-introduced for Canadian-built ships; that EDC equivalent loans be available to domestic operators; that Arctic-class vessels for natural resource transportation and exploration be built and registered in Canada; and that various other measures be undertaken to provide greater protection than now exists against Commonwealth and foreign-built vessels. The 1980 brief does not make explicit reference to deep-sea shipping.

The Interests of Importers and Exporters

Seaborne trade is of considerable importance to Canada; so, as we could expect, Canadian importers and exporters (hereafter simply referred to as "shippers") have shown an active interest in proposals for the development of Canadian-flag shipping. But, they have only reacted to, not initiated, proposals for encouraging a Canadian fleet. The perspectives of shippers are diverse. They depend on the size and location of firms, the nature of the products they use or sell and the relationship of shippers to international shipping arrangements.

The Involvement of Shippers in International Shipping

Sales terms prescribe the location at which the buyer assumes the title to the goods and becomes responsible for the costs incurred in the delivery of the goods. Usually, but not always, the buyer or his agent assumes responsibility not only for the costs but also for the arrangements made from the point at which the ownership of the goods is transferred. Various terms are used to describe the specific location at which the title passes. The most frequent ones used in international seaborne trade are "free on board" (f.o.b.) and "cost, insurance and freight" (c.i.f.). Under f.o.b. terms, the goods are "delivered" to the buyer when they cross the ship's rail in being loaded onto the vessel. Under c.i.f. terms, shipping expenses and insurance are the responsibility of the seller until the goods cross the ship's rail at the destination port. Thus, when goods are sold f.o.b., the importer is usually responsible for the transportation arrangements. When they are sold c.i.f., the exporter has the responsibility.

No statistical evidence is available on the extent to which Canadian shippers are responsible for international shipping arrangements. However, the conventional wisdom among persons familiar with international trade (both shippers and shipowners) is that Canadians have been slow to control the international movement of goods and that too few now do so. Some people believe for instance, that significant benefits could be gained if some grain sold by the Canadian Wheat Board were sold c.i.f. rather than f.o.b. The coal trade with Japan is sometimes viewed as one in which some Canadian control of shipping would be advantageous, although why this would raise the f.o.b. value of coal has not been made clear. However, an opportunity to achieve logistics economies through c.i.f. sales of coal in Japan has been found by an Australian/Japanese joint venture which will distribute coal stored in Japan "to those Japanese companies with demand for the fuel but not large enough by themselves to negotiate contracts direct with Australian suppliers."[52]

The control of shipping arrangements can lead to cost savings when goods can be moved in bulk or production and transportation arrangements can be integrated. Economies of scale might be achieved by shipping sulphur in bulk to a foreign port from which smaller quantities could be sold to small buyers. If volume movements were to occur on a regular basis, it might be practical to employ specially designed ships and sophisticated logistical systems, as is done for forest products. Firms using a variety of raw materials might find that by controlling transportation they can maintain a fine balance in their inventory of raw materials. This might apply to a steel mill that mixes various grades of ore or coal.

Controlling transportation can also lead to marketing or buying advantages. Quoting a delivered price can be a service advantage, as lead times can be significantly reduced when selling out of an inventory in a foreign country. Finally, cost savings achieved through bulk transportation arrangements can result in a larger market share and/or a higher profit margin than would otherwise be possible.

The existence of such potential advantages does not mean that Canadians should always control transportation arrangements. In some market conditions, the foreign party might be in a better position to achieve efficiencies of volume and integration. What Canadian shippers should try to ensure is that the location of control makes sense and that they get some advantage from it.

Some shipping arrangements exist because of precedence and may be difficult to change because of vested interests. Some companies and some governments have general policies of selling or buying on f.o.b. or c.i.f. terms. Japanese shippers frequently control transportation; Russia, China, India and some other countries do the same. When these policies give rise to inefficient transportation or injure Canadian interests, new terms or arrangements should be negotiated. If foreign governments are involved, Canadian government assistance might be needed, as occurred in 1979, when problems arose with the imposition of a cargo preference law by Korea.[53] Significant changes in well-established trade arrangements are only likely when the Canadian bargaining position is strong.

Many Canadian firms have sophisticated international shipping arrangements. Alcan, for example, not only controls the movement of bauxite and aluminum in bulk carriers, but has also developed the liner services of Saguenay, described earlier. In British Columbia, the forest products industry has a substantial tonnage of special purpose ships on long-term charter. Seaboard has a fleet of chartered ships including two Norwegian-built Ro-Ro vessels which carry package lumber to Japan and return with Japanese cars. Seaboard also has an interest in the liner Ro-Ro service offered by the Pacific Australia Direct Line between Australia and the Pacific Coast of North America. MacMillan Bloedel now has well over a decade of experience using specialized lumber carriers designed and time chartered to meet specific trade route requirements. Potash and sulphur industries sell their products to some markets on c.i.f. and to others on f.o.b. terms. The chemical, steel and petroleum companies in Eastern Canada have sophisticated transportation departments, although transportation arrangements are sometimes integrated with the logistics of U.S. firms.

The general pattern that emerges from examining terms of shipment in overseas trade is that in some instances a change in terms could benefit Canadian interests, but they are less widespread than often believed. Certainly, general policies, whether they are followed by foreign governments, foreign corporations or domestic organizations may be rightfully questioned, but the optimal distribution of control over transportation arrangements is more likely to be found in an analysis of logistical conditions than in a dogmatic pursuit of extended corporate control. Only if a change of responsibility for transportation arrangements brings about cost savings or marketing advantages is that change advantageous.

Trade conditions have been reviewed at some length to emphasize two points. First, shippers, like some shipowners, control a

significant amount of deep-sea tonnage. Second, the establishment of f.o.b. or c.i.f. terms is a matter to which major corporations have given significant attention; in general they believe that existing terms are consistent with their commercial interests. Thus, efforts to change shipping terms to give Canadian shippers more control, thereby hopefully creating more Canadian-flag shipping, would not likely be seen by these firms as a means of keeping down the landed cost of the imports or of keeping up the f.o.b. value of exports.

The views of shippers

The most explicit opposition to measures to encourage the development of Canadian deep-sea shipping has been stated by the Council of Forest Industries of B.C. (COFI).[54] The opposition is based on the belief "that a Canadian Merchant Marine will ultimately face threats to its survival from free economic competition."[55] The Council argues that this will ultimately result in either higher government spending through supportive subsidies, or in higher freight rates for Canadian shippers under some form of cargo reservation. The Council is not persuaded that national benefits would accrue from the balance of payments effects of Canadian shipping or that a merchant marine is necessary to resolve problems created by protectionist actions of other governments. COFI favours a separate consideration of shipbuilding and deep-sea shipping policies.

The Canadian Manufacturers' Association (CMA) does not share COFI's position on shipbuilding. It argues that "if it is...in Canada's national interest to promote Canadian shipping it would be consistent to provide comparable incentives to Canadian shipbuilders and operators."[56] But, the CMA does share COFI's view that current developments in international shipping markets do not warrant "public funds to be expended on establishing a Canadian deep-sea fleet."[57] The Association would rely on bilateral negotiations to resolve problems arising from flag discrimination. Joint ventures between the Government and private sector in frontier development appear to the CMA to be "more attractive commercially and politically than investment to displace efficient foreign operators on traditional deep sea routes"[58] (emphasis added). As transportation users, the members of the CMA favour the lowest possible transportation prices; they do not think that a Canadian operator could offer those prices. The CMA concludes "that the establishment of a Canadian deep-sea fleet should be approached with extreme caution."[59]

The Canadian Export Association (CEA) argues that the interest of Canadian exporters is served best by "a policy of discouraging discrimination in international shipping and encouragement of maximum competition for our cargoes."[60] It also questions, but does not deny, the appropriateness of committing public funds, whether by tax concessions or other means, to Canadian-flag shipping.

The CEA would favour growth of Canadian-flag shipping only if it were economically viable without substantial fiscal or financial support. Such support, it feels, would lead to economic distortions

in the economy. Their analysis of balance of payments and employment efforts does not give the Association confidence that Government support of Canadian shipping would be money well spent. Like other shipper groups, the CEA believes that problems created by flag discrimination would not be resolved by a subsidized Canadian flag presence and that negotiations based on a wide variety of options, is the appropriate strategy. Like COFI, they are concerned that the long-run result of measures to promote Canadian shipping would be higher costs for exporters. The CEA argues that the question of support for shipyards should be quite separate from policies for Canadian-flag shipping.[61]

The Taxpayers' Interests

Taxpayers expect the various departments of the Government to ensure that tax dollars are spent only where they produce an adequate return in monetary or intangible benefits. Taxpayers are concerned too with the incidence of taxes. There are two reasons for this. The first reason has to do with equity; taxpayers have ideas about how the cost of Government programs should be distributed between various groups. The second has to do with the opportunity cost of taxes. If taxes are collected widely, the impact on taxpayers is limited and detracts only from their marginal expenditures. If the incidence of taxes is more limited then tax rates are higher and expenditures beyond those at the margin will be denied the taxpayers. For example, a small reduction of a corporation's cash flow might cause a profitable project to be scaled down; a further reduction might cause the project to be abandoned altogether. Thus, the opportunity costs of taxes are increased if the earnings of one sector of society taxed in the past are made tax exempt and the same total taxes are needed.

To determine the extent of tax concessions, a benchmark has to be established from which deviations in the tax structure can be measured.[62] Given a fair benchmark tax structure, the amount of tax which would be collected with and without a tax concession can be estimated. The amount of tax foregone may be termed a tax expenditure.

The effect of shipping policy on taxpayers' interests may be said, then, to be the net effect of measures supported by tax expenditures and/or departmental programs on the productivity of national wealth.

Areas of Agreement and Disagreement

There is general, but not universal agreement, that shipbuilding and shipping policy should be separated. This is not a contentious matter and is not an apparent problem in the formation of a shipping policy. Marine users and interest groups agree on the need for active Government policy on deep-sea shipping rather than the essentially passive policy of recent decades. But they disagree on the desirability of new tax or financial measures to support the development of a Canadian deep-sea fleet. This difference is an

obstacle in formulating a new shipping policy by the current Government.

The differences of opinion between the parties arise over the following questions:

1. Can Canadian shipping be competitive in world markets?

2. Do the tax and financial measures proposed by shipowners impose costs on other taxpayers?

3. How serious a threat to Canadian trade interests is posed by protectionist developments in world shipping?

4. What alternative actions can Canada take to protect its interests?

5. Will Canada realize employment and balance of payments benefits from Canadian-flag international shipping?

6. If Canadian-flag shipping, developed following favourable Government legislation, turns out to be uncompetitive in world markets, would some future Government sustain Canadian shipping at the expense of users and/or taxpayers?

7. What, if any, special policy measures should apply to Arctic shipping.?

Each of these questions, which are addressed in the next three chapters, is a part of the broader problem of whether measures to benefit Canadian-flag, deep-sea shipping would lead to an improved use of Canadian resources.

CHAPTER IV

THE EQUAL OPPORTUNITY ARGUMENT

Shipowners argue that if they enjoyed tax and financial measures comparable to those available in many other countries, they would be competitive and profitable in a business now effectively denied to Canadian-flag ships. They also argue that this could be achieved at little or no loss of corporation tax because little Canadian-flag deep-sea shipping exists now.

These arguments are analysed below. The first part of the analysis is to establish whether Canadian tax and financial measures applied to shipping are less favourable than those existing in selected other countries. The second part examines the evidence that Canadian shipping could be commercially competitive if operating under "comparable" tax and financial conditions. The third part examines the implications of specific tax and financial measures for shipping and for resource employment in other sectors of the Canadian economy.

A Comparison of Foreign and Canadian Tax and Financial Measures Affecting Shipping

The competitive conditions in international shipping since World War II have been greatly influenced by the requirements for ship registration and the corporate tax policies of some developing nations. These "flag of convenience" countries, of which Liberia is the most significant, have made it easy for ships owned by foreign nationals or companies to fly their flags and enjoy a legal base with limited taxation and considerable freedom from government regulation. These countries have been regarded, also, as offering "flags of necessity" or "open registry". The advantages enjoyed by owners using flag-of-convenience registry led various governments to modify their tax policies. In 1970, the United Kingdom Committee of Inquiry into Shipping (the Rochdale Committee) concluded -

> their [companies with vessels under open registry] freedom from tax on retained profits gave them an advantage over

UK operators in the past, which is only countered now by the arrangements, favourable as compared with those for other industries, which are operative for UK shipping companies.[64]

Conditions of registration under flags of convenience

Several specific factors can make registration under flags of convenience attractive to shipowners. The main advantages seem to be reduced operating costs because of flexiblity in manning and protected profits because of the absence, or low level of corporate taxes. A registry fee and an annual fee, based, on tonnage, are normally the only charges made. A guarantee or acceptable understanding regarding future freedom from taxation may also be given. Using flags of convenience as a tax haven is an effective means of deferring the payment of tax until profits are repatriated to beneficial owners, when they may be subject to tax.

In Liberia, the registration fees are an initial $1.25 per net registered ton. In Liberia, the registration fees are an initial $1.25 per net registered ton and an annual fee of 10 cents per net registered ton. In Panama, the initial fee is $1.00 per net registered ton plus other minor fees and an annual 10 cents per net ton. Liberia guarantees that fees will remain unchanged for the twenty years following initial registration. In spite of the low level of the fees, it is estimated that they account for between five and eight per cent of Liberia's annual budget.[65]

The flag-of-convenience countries typically impose no national standards for safety or work conditions, nor are the interests of the seafarer protected by a national trade union. However, most of the countries are parties to the international conventions and use the international classification societies to ensure that vessels meet safety standards. Investigations and operating experience have shown that low-standard, "shoestring" fleets can operate under flags of convenience, but most owners using flag-of-convenience have modern, well-managed vessels which neither exploit labour nor pose pollution or safety hazards.

In 1970, the United Kingdom Committee of Inquiry into Shipping concluded that the flags of convenience provided a necessary refuge for owners who would not have operated vessels under their own national flag. Further, "by far the greater part of the ships of these registers is composed of modern vessels which bear full comparison with those of other registers."[66] The record of the fleets has continued to improve, partly as a result of international pressures.

Registration under European flags

The existence of flags of convenience caused the traditional maritime nations to reassess policies that affected their national-flag vessels. This reassessment led the maritime nations of

Western Europe to give shipping favourable treatment in order to offset the advantages enjoyed by flag-of-convenience carriers. Tax allowances and assistance in ship financing have been the primary measures adopted.

Tax allowances. The variety of direct and indirect taxation measures precludes a conclusive comparision of the relative advantages for shipowners of registering ships in the various countries. However, the general results of the tax measures are clear: international shipowners usually pay no taxes as long as they are investing in new or used ships.[67]

The widespread nature of tax allowances is indicated in Exhibit 5, which shows the position of twelve OECD countries on various taxation measures. In nine countries, depreciation (capital cost allowance) may be claimed prior to the delivery of a vessel; in six countries, profits from the sale or loss of vessels may be applied against the capital cost of replacement vessels. The methods and rates of depreciation vary greatly. Only the Netherlands has a maximum depreciation allowance as low as the Canadian 15 per cent per year on a declining balance basis; however, in July, 1978, the Netherlands introduced a new measure called the Investment Account to stimulate investment.[68]

Exhibit 6 summarizes the major tax measures in Germany, Norway and the U.K. These countries are selected because they have maintained significant national-flag fleets. They each allow early and rapid depreciation of the capital cost of ships. The U.K. simply allows full writeoff over any time period. Germany and Norway also allow tax-free reserves to be set up for vessel replacement, and for book profits to be set against the cost of new buildings (the latter is allowed for some vessels in the U.K.).[69] In the face of a decline in the U.K.-owned fleet since 1976, British owners have sought, unsuccessfully, reforms respecting capital gains taxes.[70]

These programs protect cash flows from tax during periods of profitable operation. This can support the establishment of cash reserves for fleet replacement or expansion; but, unless some profits are kept as liquid assets, it does little to help companies during unprofitable periods--a recurring phenomenon in international shipping. The tax allowance system provides the greatest assistance to the more efficient companies, as measured by their profitability, and is an efficient way to allocate resources among shipping enterprises.[71]

Ship financing and related measures. In addition to the various tax measures, the European countries have other programs which indirectly and directly assist shipping. The considerable subsidies available to the shipbuilding industry provide indirect assistance to shipowners by reducing ship costs. Direct assistance to shipowners is provided by various measures. A 1976 report indicated that at that time, one or more types of financial assistance programs were provided by ten of twelve European countries.[72] Construction grants were

EXHIBIT 5

Position of Twelve OECD Countries on Certain Tax Allowances

Tax Allowance	Yes[a]	No[a]
Book-profits resulting from sale or loss of a vessel may be deducted from price of replacement vessels	6	6
Depreciation possible from time of contract or payments	9	0
Maximum depreciation rate equal to or less than 15% declining balance	1	11
Tax-free reserves for vessel replacement	6	0
Tax-free reserves for repairs and/or reclassifications	9	0

Note: a. Not all countries replied to all questions. A country is listed according to the most common circumstances; exceptions to the norm exist. Greece responded to the OECD survey but is not included in the tabulation as no imcome tax is levied against shipping companies.

SOURCE: OECD Financial Assistance to Shipowners, DAF/MTC/76.37, Paris, 16th Sept., 1976; and DAF/MTC/79.28, Paris, 18th July, 1979.

EXHIBIT 6

Taxation of Shipping in Germany, Norway and United Kingdom, 1978

Tax Issue	Germany	Norway	United Kingdom
1. Value for write-off	cost less scrap value	cost	cost less scrap value
2. Basis for CCA[a]	Deduction of book profit from sale or loss of previous vessel		Deduction of book profit only to October 28, 1970
3. CCA commences	40% of advance payments without creating a loss[b]	25% on contract up to 50% of taxable income[c]	As expenditure incurred
4. CCA Rate	Straight line or declining balance (16.67%)	Straight line with option 25% initial and extra half normal rate for five years	Free for new ships. Free or 25% declining balance for used ships
5. Useful life	12-14 years	12-20 years	Any
6. Tax free reserves			
- for new ship	Yes (use in 2-4 years)	Yes (use in 8 years)	No
- for renovations etc.	No	Yes	No
- for risk not covered by 3rd party insurance	No	Hull risks only	No
7. Tax rates[d]	Same for all companies/individuals		
8. Time limit on			
- loss carry forward	5 years	10 years	unlimited
- loss carry back	1 year	Not allowed	1-3 years
9. Tax on capital	1% for companies	0.4% for companies	none

a. 'CCA' is Capital Cost Allowance or depreciation allowed for tax purposes.

b. Does not affect normal annual depreciation, but reduces amount of 40% of purchase price which may be taken as special allowance subject to constraint on loss created.

c. Does not affect normal annual depreciation.

SOURCE: OECD, Financial Assistance to Shipowners, DAF/MTC/79.28 Paris, 18th July, 1979

available in France, Germany and the Netherlands. Government loans were made available in Belgium, Finland, Germany, Ireland and Japan. Loan guarantees for commercial loans were given in Belgium, Finland, Germany, Switzerland and the U.K. Interest subsidies on commercial loans were provided in Belgium and France. Six of the countries providing financial assistance discriminated in favour of their nationals; only Ireland, U.K. and the Netherlands did not do so.

The variety of measures used to provide financial assistance can be explained, in part, by countries' trying to prevent their domestic owners from being placed at a competitive disadvantage by the system of export credits on ships.[73] The latter system, which operates within the terms of the OECD Understanding on Export Credits for Ships, provides favourable financing terms for ship export sales.

Other assistance measures. Both Norway[74] and the U.K.[75] provide special tax concessions to seamen which aid shipowners in attracting national crews. Every country but the Netherlands[76] also provides financial support for training seamen.

An important source of low-cost capital is the leveraged lease. Since chartering is common in shipping, lease financing is readily undertaken. Under the leveraged lease, a financial institution as lessor is able to take full advantage of the accelerated depreciation available on shipping, and passes on some of the benefit by charging lower interest rates than would otherwise be necessary.[77] This form of financing could be attractive to a shipping company which does not have the level of profits needed to take full advantage of the depreciation tax shield.

The application of tax provisions to companies affects the corporate structure as well as the company's profitability and resource allocation. This is significant in shipping because of the common existence of corporations with only one or a few ships that are wholly owned by a single parent corporation. This situation can result from any of the following circumstances: conditions may have favoured ship building and operation in a country for a short time, when one- or two-ship companies are established; the circumstances applicable to particular trades may make a diversity of companies and national registrations beneficial; restricting the size of individual corporations might limit liability. In some countries, for example, the U.K., consolidated returns are allowed for tax purposes, thereby enabling losses in one company to be offset against income in another.[78]

Conclusion. Although the description of tax measures and financing arrangements overseas is in summary form, and the effects cannot be quantified, there is no doubt that European countries have introduced special measures to assist the profitable operation of national-flag vessels.

Registration in Canada

Ships are presently registered in Canada pursuant to the Canada Shipping Act under which a ship may be registered in Canada if it is owned by a Canadian citizen, a British subject or a company incorporated in a Commonwealth country. However, on June 30, 1978, Parliament passed the first sections of the Maritime Code Act, which is proposed to supersede the Canada Shipping Act. Included in these first sections of the new Act are revisions to conditions for registering ships in Canada. Due to the complexity and interlinkages of various sections of the Canada Shipping Act, the completed sections of the Maritime Code will not be proclaimed until it has been passed in its entirety.

Under the new Act, the right to register vessels in Canada is to be restricted to Canadian citizens residing in Canada, and to companies incorporated in Canada whose main places of business are in Canada, and for whom two-thirds of the directors and the principal officers are Canadian citizens residing in Canada.[79] The conditions do not preclude a predominantly foreign-owned Canadian corporation from registering ships in Canada.

The change is in keeping with the recommendations of the 1969 report of the Canadian Transport Commission,[80] which favoured measures that "would help to assure...that the Canadian interest is given the weight to which it is entitled."[81] Should registration of deep-sea ships in Canada became attractive, the provisions of the Code would, in effect, prevent Canada from becoming a flag-of-convenience country for foreign capital.

Income tax provisions affecting shipping in Canada. The main income tax measures affecting shipping as laid down in the Income Tax Act, are compared here to measures existing commonly elsewhere. This is done not because the measures adopted elsewhere should necessarily be adopted in Canada, but because Canadians can avail themselves of these measures by incorporating and registering ships abroad.

A new ship built and registered in Canada may be depreciated at 33-1/3 per cent on a straight-line basis. Currently, only in special circumstances and with previous levels of shipbuilding subsidies would this rate of depreciation make a Canadian-built ship a better investment than a foreign-built ship for which the maximum allowable rate of depreciation is 15 per cent on a declining-balance basis.

Canadian shipbuilding costs are generally too high to allow owners to employ Canadian-built ships profitably in deep-sea trades. The 15 per cent declining balance rate of depreciation is the lowest of the rates reported in the OECD survey. The tax shelter provided is not made comparable with that available in several other countries by the capital cost allowance being allowed for vessels under construction. Since the passage of Bill C-17 in November 1979, investment tax credits, previously not available to shipping, have been so extended. Section 127 of the Income Tax Act allows for the

deduction of an investment tax credit amounting to 7 per cent of the cost of a new ship acquired after November 16, 1978.

Tax-free reserves are allowed for quadrennial inspections or other special surveys required under the Canada Shipping Act at the rate of one-quarter of the estimated cost per year. Tax-free reserves are not allowed for vessel replacement and half of any capital gains on the sale of a vessel are taxed. However, if a vessel is lost or destroyed, the insurance proceeds are not subject to capital gains tax as long as they are used to acquire a replacement vessel within two years.

The same rates of taxation are applied to taxable income from shipping as are applied in the economy in general, as is the practice generally in other OECD countries (except in Greece where no income tax is payable on international shipping income). Canadian residents are taxed on their world income. For individuals, residency is defined on the basis of residence. No special provision or interpretation applies to seamen. For corporations, residency is dependent on whether a corporation was incorporated in Canada and whether the "mind and management" meet in Canada, i.e., if the corporation's affairs are managed from Canada.

Many Canadian companies are able to defer the payment of taxes until earnings are repatriated by establishing a foreign shipping subsidiary in a flag-of-convenience or European country. Since the subsidiary shipping corporation is not incorporated in Canada and, as long as the management of the business is not conducted here, the company can be liable only for tax on income earned in Canada. However, even the shipping income earned in Canada may not be taxable because of a provision in the Income Tax Act which states that "income earned in Canada by a non-resident from the operation of a ship or aircraft in international traffic" shall not be included in taxable income provided that the non-resident's country extends similar relief to Canadian firms.[82] Canada has such reciprocal agreements with the major flag-of-convenience countries as well as with OECD members.

Financing conditions in Canada. Canadian corporations have reasons other than tax-avoidance for establishing shipping corporations abroad. Conditions for the financing of ships are less attractive in Canada than in many other countries.

The commercial basis on which ships are financed is comparable to that for any enterprise; the duration of funding and the terms it carries depend on the perceived risk associated with the investment. The risk may be evaluated on the basis of the earnings prospects of an entire corporation as well as those of a vessel. In several countries, the commercial risk is mitigated by government guarantees. No such program exists in Canada. Two favourable financing vehicles available to industry generally were removed in 1976 and 1978.

Prior to 1976, the leveraged lease was commonly used in Canada. However, since the budget of 1976, lease financing of ships has not

been popular since capital cost allowances have been restricted to the reduction of taxable profits from lease income only.

Another attractive financing vehicle was removed in 1978 when the government terminated the use of income debentures and term-deferred shares as financing techniques. Up to that time, the returns on these instruments were not taxable so that banks were able to require lower returns on them.

After World War II, proceeds from the sale of the war-built Park ships could be placed tax free in escrow, to be used within seven years for vessel replacement. These funds and the so-called "angel plan", which allowed accelerated depreciation (33 1/3 per cent) to be applied by banks and normal depreciation (15 per cent) by operators holding a charter with an option to buy, contributed to the rapid expansion of the Great Lakes fleets prior to 1966.[83]

In Canada, the government is involved in ship financing only through the programs of the Export Development Corporation (EDC). The EDC provides loans, usually for longer periods than commercial institutions, and provides loan guarantees. However, these aids are only available to foreign shipowners purchasing vessels in Canada. Canadian companies can take advantage of EDC financing only through overseas subsidiary corporations.

Canadian coastal shipping. In addition to tax and financing conditions, the various regulations dealing with the participation of foreign-flag vessels in Canadian coastal trades are also significant to the practicality of operating Canadian-flag ships in deep-sea trades. This is because they affect the well being of the domestic shipping industry, which is a source of human and capital resources for deep-sea vessels. Therefore, a brief description of the regulations governing coastal shipping is included here.

Canadian coastal shipping has long enjoyed a significant level of natural economic protection against the inroads of foreign-flag vessels. This natural protection has been increased by legislation. While coastal trades are open to Commonwealth ships (except for the Great Lakes), they are closed to other foreign flags except on a waiver basis. However, since the Commonwealth includes flag-of-convenience countries, the full force of international shipping competition is potentially available to shippers. It is limited only by the economic separation between coastal and deep-sea trades and by the limited number of ice-strengthened Commonwealth ships.

The domestic coastal shipping on the west coast is dominated by the tow-boat industry, which is closely integrated with the forest industry. The local skills in design, management and operation ensure the comparative advantage of Canadian-based firms, employing Canadian crews and paying Canadian taxes.

On the east coast, the operation of Commonwealth vessels is more

practical although the absence of regular, high volume movements typical of deep-sea vessels is not conducive to the effective use of such vessels.[84] Commonwealth-flag operations are most likely on charter terms during the summer months. Canadian vessels may be employed in international coastal or sometimes ocean trades, particularly during winter months.[85] Only the Great Lakes and St. Lawrence ports have large and regular traffic flows sufficient to attract international shipping.

Until the completion of the St. Lawrence Seaway, most Canadian domestic shipping on the Great Lakes was provided by Canadian vessels even though the trade was open to Commonwealth ships. In 1958, the Spence Royal Commission recommended that Canadian coastal trade remain open to British-flag ships. With the completion of the St. Lawrence Seaway, an increasing number of British vessels entered the east coast and Great Lakes trades, and in response, the Canadian companies sought to secure their market share either by protective legislation or by registering their vessels in Commonwealth flag-of-convenience nations. The decision of Canada Steamship Lines and Upper Lakes Shipping to transfer some of their vessels to subsidiary companies in Bermuda was important to the passage of amendments to the Canada Shipping Act in 1962. That Act reserved Canadian domestic trade between points west of Anticosti Island for Canadian-flag vessels. (Anticosti Island is, also, the eastern limit for safe navigation of vessels with dimensions and structural standards appropriate for Great Lakes conditions alone.).

International traffic between U.S. and Canadian ports within the Great Lakes is open to any foreign-flag vessel. However, the comparative disadvantage in these trades of ships designed basically for deep-sea operation affords significant protection for Canadian Great Lake vessels against these foreign-flag vessels. Opposition from Canadian shipping firms and unions to the use of foreign-flag vessels influences shippers in their selection of carriers.

Competition exists, also, between foreign-flag vessels carrying Canadian or U.S. cargoes directly from the Great Lakes to off-shore ports, and Canadian-flag vessels carrying the cargoes to a St. Lawrence or Maritime port for trans-shipment. The practicality of the alternate routings depends on many factors, so that measurement of competition is not practical. However, Exhibit 7 shows the shares of cargoes by flag for the Montreal-Lake Ontario section of the St. Lawrence Seaway in 1979. Canadian-flag vessels built for the Great Lakes Seaway services dominate the trade. Foreign vessels entering the Great Lakes often do so with general cargo, for example, European steel, which accounts for their domination of the general cargo traffic. Outbound, they carry grain or other bulk cargoes.

Cabotage (the reservation of trade to national-flag ships) ensures Canadian-flag carriage of domestic trade only on the Great Lakes. On the east and west coasts, although Commonwealth ships have access to the trades (subject to a 25 per cent customs duty, 25 per cent of 1/120th of the fair market value of the vessel per month for

EXHIBIT 7

Traffic by Country of Vessel Registry, Montreal-Lake Ontario Section
1979

(millions cargo tonnes)

Country	Grains	Bulk N.E.S.	General Cargo	Total[a]
Canada	15.4	19.9	0.05	35.3
United States	0.05	1.2	0.01	1.2
Greece	2.8	1.3	0.8	4.9
Liberia	1.8	1.6	0.6	4.0
Yugoslavia	0.8	0.3	0.2	1.3
United Kingdom	0.7	0.3	0.3	1.2
TOTAL	24.9	26.8	3.7	55.3
Canada as % of total	61.9%	74.2%	1.3%	63.8%

Note: a. Totals may not add due to rounding

SOURCE: The Seaway, 1979. St. Lawrence Seaway Authority, Table 6, p. 24.

temporary entry), Commonwealth vessels are only used on the east coast and then to a limited extent. However, shippers' access to Commonwealth-flag vessels may hold down the rates of Canadian-flag coastal services in the same way that shippers' access to shipping holds down railway rates.[86] The success of Canadian domestic services, whether protected or not, provides a basis from which to enter deep-sea services under Canadian-flag should circumstances warrant.

Implications for Canadian shipping policy

The combined effects of tax and financing conditions in Canada and elsewhere make the registration of deep-sea ships in Canada unattractive for Canadian and foreign corporations. For Canadian firms, participating in the ownership of deep-sea shipping is most likely to be attractive through foreign corporations able to take advantage of financing and tax benefits associated with flag-of-convenience and selected OECD countries. It is, also, the only way by which Canadian firms could take advantage of Canadian EDC financing.

The financing and tax conditions in other countries are significantly different for international shipping than for other industries. In the post-war period, the absence of income tax in flag-of-convenience countries established a corporate financial environment to which OECD members have responded as a means of retaining the registration of carriers using their flag.

The international mobility of resources and the favourable circumstances for the financing of shipping services have facilitated the development of international trade. In 1979, the Liberal Government concluded -

> On balance, open registry shipping would appear to have been in Canada's interests, certainly to the extent that it has introduced competition into the international market and provided Canadians with opportunities to participate in international shipping.[87]

Notwithstanding this conclusion, the Maritime Code moves to make ship registration in Canada more restrictive and no changes have been made to fiscal policies to make those policies more comparable with those existings elsewhere.

The Potential for Profitable Operation with Canadian-Flag Ships

Before considering whether Canada should deviate, as other OECD members have, from prevailing domestic tax and financing conditions in order to encourage Canadian-flag shipping to expand from its current coastal base, it is necessary to determine whether Canadian-flag shipping would develop under a more favourable government policy. This question is considered here.

During the 1970's, two studies were published which compared the cost of operating vessels in deep-sea trades under Canadian and foreign registry. The first study, published in 1970, was carried out by Hedlin Menzies and Associates Ltd.[88] It examined the economics of operating various types and sizes of foreign-built bulk carriers in a number of Canadian trades. The costs of operating vessels under Canadian registry were estimated to be higher than under foreign flags because of higher labour costs as well as higher tax rates. Government assistance to enable Canadian-flag vessels to be operated profitably was not considered economic although no cost-benefit analysis was conducted.

The second study, published in 1977, was carried out by Alcan Shipping Services Limited. It examined the potential profitability and national economic interests in a wide range of Canadian-flag options.[89] The options included Canadian and foreign-built ships employed in bulk, tanker and container trades. For all vessels and routes, the lowest cost option was the foreign-built and foreign-registered ships. This was because Canadian labour costs always exceeded those of foreign-flag vessels. However, since long-run levels of freight rates were estimated independently of the vessel costs used in the study, some Canadian-flag vessels were estimated to be able to operate profitably on certain routes.

Some shipowners question the appropriateness of using general cost and revenue estimates, as these two studies did, to determine the competitive potential of Canadian-flag shipping. They have two reasons for this.

First, the shipping industry is not composed of firms competing to provide identical services at least cost. It is a heterogeneous industry in which the imaginative design of ships to fit particular trades or a combination of trades can be important. Therefore, a high-cost operator may be able to offset Canadian labour costs. Further, competition to meet the needs of particular shippers is largely but not entirely in terms of the freight rate required; various service attributes can be important too. Some Canadian shipowners argue, therefore, that even if their costs would be higher than those in other countries, this would not necessarily exclude them from profitable and efficient operation in certain trades.

Second, forecasting the actual cost of Canadian crewing may be difficult. The level of total crew costs depends not only on wage rates and crew size but on the actual performance of labour, on the amount of overtime necessary, on the level of repatriation costs from foreign ports and on the amount of maintenance work done by shoreside labour. Some persons are optimistic and others pessimistic about the reliability and performance that can be expected of Canadian crews engaged in deep-sea trades. But they agree that the actual costs will be significantly influenced by the performance of crews, that this may well vary from trade to trade and that it is difficult to forecast.

Shipowners who are confident that Canadian-flag ships can compete

in deep-sea trades emphasize that the labour cost disadvantage has diminished in recent years. Three general trends account for this. First, the general rate of increase in crew wages has been higher in traditional maritime countries, such as Japan, the U.K. and Norway, than in Canada. Second, the increase of other costs, particularly fuel, has been so rapid that labour has decreased as a percentage of total costs. Third, the increased capital-intensity of ships has reduced crew sizes and further reduced labour as a percentage of total cost. They argue that, as a result, Canadian-flag vessels have a greater chance of being profitable now than in the past.

Shipowners also point to the following to demonstrate the potential for competitive operation by Canadian ships: the plan of Upper Lakes Shipping Limited to replace its two Canadian self-unloading deep-sea vessels with new Canadian vessels; the increase in the number of bulk carriers of Seaway dimensions built with ocean-going capability; the operation of two Canadian-flag ships by Saquency Shipping Limited; the placement of a Canadian crew on a Liberia-flag tanker of Hall Corporation Shipping Ltd.,[90] and the operation, for some months, of a Canadian crew on a deep-sea vessel by Maple Leaf Shipping Ltd. of Vancouver.[91] Not all of these ventures were successful: they are cited as evidence that the potential to operate with Canadian crews is higher than formerly and that a more favourable government policy environment could make practical an expansion of Canadian-flag deep-sea operations. Shipowners note, also, that not all shipping operations gravitate to flag-of-convenience countries where labour costs can be minimized.

Canadian shipowners do not expect to be competitive in all trades even if operating under more favourable government policies. The actual competitiveness of Canadian-flag shipping will depend on the precise tax and financial measures adopted by the Government, the contracts worked out between seafarers and shipowners, and the performance of Canadian crews. Most shipowners, in assessing the potential for Canadian-flag shipping, see the development as being gradual. Their perspective and judgement is summed up in the following statement by Mr. L.D. Pathy, President of Fednav Ltd.:

> If we want to have a Canadian merchant marine it must be economic and competitive. My earlier comments indicated that I don't believe this is possible as a generality but I do believe there are certain trades where Canadian-manned ships can be competitive internationally. Eventually these trades may be expanded as our expertise and cost-effectiveness increase.[92]

Marine interest groups generally expect that, assuming Canadian shipping services develop only where they are attractive to shippers, a definite but limited expansion of Canadian deep-sea shipping would occur. The presence of some albeit limited activities currently, and the greater comparability of Canadian with European costs now than was formerly the case are consistent with this conclusion. The development of technology and shipping needs favourable to the use of

bulk carriers of Seaway dimensions in deep-sea trades and to the developing of Arctic shipping, provide opportunities for the expansion of Canadian deep-sea shipping. However, the extent of the development depends on intangible factors and future arrangements, so a forecast can indicate only that the development will be limited and gradual. Particularly important to the extent of the development will be labour supply and productivity.

Alternate Tax and Financial Measures in Canada

The complex application of tax measures to confidential corporate data precludes a detailed analysis of alternate tax measures. Therefore, this analysis is restricted to examining the general economic implications of alternate structures of tax and financial measures on corporate profits and on the allocation of resources.

Exhibit 8 lists the alternate tax and financial measures to be evaluated here. They are derived from, but not identical to, the proposals of shipowners. The first five measures are predicated on the proposition that shipowners, in general, pay little or no corporate income tax as long as they are expanding their fleets. The capital cost allowance measures (CCA) allow the cost to be applied against income from different sources. This is an important feature. In the joint brief of 1978, shipowners did not make clear the income against which an accelerated CCA would apply. In their joint brief of 1979, they made clear that it ought to apply against any marine income.

Measures to provide accelerated capital cost allowance

In the private sector of the economy, resources are allocated primarily in ways that ensure the maximum financial return on capital in the long run. If all firms faced the same tax structure, resources would be allocated to those sectors of the economy yielding the highest profits. This allocation of resources would not fully reflect national social or political values, so government intervention in the economy would be necessary. Intervention may be via regulations, direct operation, direct payments or tax expenditures. Each of these means is used in practice to ensure that resources are allocated in ways consistent with national economic, social and political objectives.

Various factors affect which form of intervention the Canadian Government uses to achieve its objectives. Included in these factors are the market and competitive regimes in which Canadian firms operate. In the case of shipping, one reason for the proposition that tax expenditures (concessions) are desirable, is the influence on the shipping market of such measures in other countries. Proponents of this position argue that Canadian investment in Canadian-flag shipping is less than optimal, and that resources being used elsewhere could be used more efficiently to benefit Canadian shipowners and shippers. However, this is not necessarily the case. The economic loss may be mitigated by Canadian owners operating vessels under foreign

EXHIBIT 8

Alternate Tax and Financial Measures Favourable to the Employment of Canadian-Flag Ships in Deep-Sea Trades

1. Allow accelerated capital cost allowances on deep-sea ships to protect deep-sea earnings from tax.

2. Allow accelerated capital cost allowances on deep-sea ships to protect any shipping earnings from tax.

3. Allow accelerated capital cost allowances on deep-sea ships to protect earnings of the owner/operator from tax.

4. Allow accelerated capital cost allowances on deep-sea ships to protect the earnings of any company through the leveraged lease.

5. Allow tax-free reserves for vessel replacement.

6. Tax concessions for seamen.

7. Reduce rates of interest on loans through credit support comparable to Export Development Corporation loans.

8. Establish a loan guarantee program.

registry. Further, making the investment opportunities for Canadians in international shipping the same as those available elsewhere would change the relationship between shipping and other investment opportunities within Canada. This would have many ramifications, which are examined below using a hypothetical example.

Two Canadians, Mr. Cunard and Mr. Crow, have similar entrepreneurial capabilities. If they engage in shipping that is subject worldwide to a 50 per cent tax rate, they could expect to earn, on average, net profits of $5 million per year and to pay taxes of the same amount. The resources which each employs may be regarded as yielding an average annual productivity of $10 million.

If taxes on ship earnings are abolished everywhere except Canada, shipping activity in the rest of the world will tend to expand. Because shipping is a highly competitive industry with ease of entry in the long run, most of the saving derived from the elimination of tax will be passed on to users in the form of lower rates. With freight rates established at a new lower level, the alternatives for Cunard and Crow are to stay in Canada and earn $2.5 million per year after tax (half their present profit); to locate the shipping enterprise in another country and earn $5 million per year, which would be subject to tax if repatriated; or to go into farming, where they would be less productive but could expect net profits of $9.8 million, for an after-tax income of $4.9 million per year. For reasons of personal preference, Mr. Cunard operate decides to operate ships from another country, and Mr. Crow goes into farming. The question now is whether Canada would be better off foregoing the tax on shipping.

If Canada eliminates the tax on shipping income, Cunard and Crow will both find it attractive to engage in shipping from Canada. However, the total productivity of Canadian resources will go down when Crow changes from an activity producing net wealth of $9.8 million to one producing $5 million.

The example points to the crux of the tax concession issue: how much would tax concessions cost the economy as domestically employed resources, which yield high profit and tax, (or, an alternately, social or political benefit) are transferred into shipping, with higher profits but no tax; how much would tax concessions that result in the repatriation of shipping benefit the economy? Two secondary questions follow. Would a burden of taxes be shifted onto other sections of the economy? Would shippers benefit from an increased efficiency in shipping services?

The answer to the first question depends on the particular form of the tax concession, that is, on which one of the first four alternatives in Exhibit 8 is followed. If accelerated CCA were allowod only against deep-sea earnings, the diversion of domestic resources would likely be slight, and the main beneficiaries would be companies with a fleet of deep-sea vessels. This is because ships are so capital intensive that tax can be deferred for an individual vessel

for many years under existing conditions. The accelerated CCA of a new ship is mainly of value if there is significant income from other vessels to protect. Therefore, the provision is more attractive to companies with fleets of vessels registered off-shore than it is to other firms. Very few Canadian-flag vessels operate in deep-sea trades, so few current earnings would gain tax relief. But Canadian companies contemplating entry into international shipping would no longer find Canadian tax policy a reason for establishing off-shore corporations; and Canadian Great Lakes operators would find tax concessions beneficial to the operation of vessels in international deep-sea trade during the winter.

Proposals to allow CCA to be applied against earnings other than those accruing from deep-sea operations all encourage the expansion of shipping because taxes on non-deep-sea earnings could be deferred. This inducement encourages the transfer of resources from other activities to deep-sea shipping, so corporate profits are increased but taxes and total productivity reduced. Therefore, costs of the policy are increased.

The benefits of repatriating current offshore shipping operations are diverse and remain largely intangible. First, wealth would be available in Canada for reinvestment where appropriate instead of remaining off shore. (The loss of capital offshore is undesirable for an economy with limited capital resources.) Second, Canada would acquire the much-needed presence of highly skilled managers with special expertise in shipping. (Shippers as well as shipowners acknowledge the need for increased Canadian managerial expertise on shipping matters.)

Beyond these direct effects are potential benefits to the economy in terms of the balance of payments and employment effects and the protection that Canadian-flag shipping may afford against protectionist measures of other governments. These are considered in later chapters.

Comparable benefits exist, also, with the effect of tax concessions in mitigating the future developments of Canadian-owned shipping off-shore. For example, current policies encourage Canadian firms that might develop expertise in serving the international shipping requirements of the Canadian Arctic, to do so through foreign subsidiaries.

The rate at which vessel registration and management would shift from off-shore to Canada would almost certainly be slow: firms with off-shore operations have established management, crews and operations; uncertainty exists about the actual productivity and costs of Canadian labour in deep-sea operations; and insufficient numbers of officers would be available to man vessels.

The effectiveness of accelerated CCA would be increased by allowing, also, tax-free reserves for vessel replacement. This has an advantage over CCA in that it does not encourage owners to invest in

ships during periods of high profits to avoid taxes. Because of the considerable volatility of the shipping market, which experiences short periods of high profits and longer periods of below normal returns or losses, tax provisions which encourage reinvestment at peak times are undesirable.

Overall, therefore, the cost of accelerated CCA as a tax shelter for deep-sea ship earnings can be predicted with confidence to be low. The benefits are less easy to predict; they would be small initially but could grow significantly. The probability that the direct benefits exceed the costs is good.

The consequences for tax incidence are insignificant. Very little (if any) corporate tax is paid now on deep-sea earnings from Canadian shipping enterprises; and the deferment of this tax would be offset by personal taxes paid annually by shipping managers and seafarers brought under the Canadian tax system.[93]

Finally, it is assumed here that Canadian-flag shipping would only be used by shippers when it is commercially advantageous to them. Shippers, therefore, would gain from the presence of the shipping although the magnitude of the benefit is not measurable. (The concerns of shippers that they might be required to use Canadian-flag ships against their best judgement is considered later.)

Tax concessions for seamen

Tax concessions for seamen are provided in the U.K. and Norway. They have been proposed by some Canadian shipowners, although, following opposition from maritime unions, there appears to be little support for the idea now. They would not be economically desirable because they would act as a subsidy on labour costs and encourage an inefficient use of labour in shipping.

Measures to reduce the cost of borrowed capital

Because of the capital-intensive nature of ships, some shipowners place more stress on Canada's need to develop means of providing low-cost capital than on the need to provide tax concessions. Two specific proposals have been made: that credit support comparable to that provided by the Export Development Corporation (EDC) be made available and that a loan guarantee program be established.

Shipowners point out that foreign corporations, including foreign subsidiaries of Canadian firms, may obtain reduced rates on loans for purchasing Canadian ships, while Canadian firms are ineligible for such support. The problems raised by EDC support being available to foreign firms but not their Canadian competitors is not unique to shipping. However, because of the wholly international nature of deep-sea shipping, the arrangement means that a foreign corporation may receive a low-interest loan and be in direct competition with a Canadian firm. The apparent inequity created by the EDC program results from its mandate to develop direct export sales. While the

mandate cannot be considered here, the suggestion that comparable credit support be given to Canadian firms will be.

The interest rate on loans is the cost of money. The rate on a particular loan reflects the general demand and supply conditions for money and the terms and conditions of the loan, such as its duration, repayment terms and the level of risk assumed by the lender. A reduction in the cost of money to shipowners implies either that the cost of money is being subsidized or that the money market has been working imperfectly, perhaps by improperly assessing the amount of risk in shipping.

A subsidy would be provided to the shipping industry if there were a net cost to the Government in providing capital at a reduced cost. Not only would such an expense be a cost to other taxpayers, but the program would result in capital being diverted to industries with lower productivity than would otherwise be the case. Within the shipping industry, more capital intensive investments would be made than warranted by the cost of capital in the country. Such consequences are opposed by shippers and are not consistent with the position of shipowners that they are not seeking subsidies.

The shipowner's argument that the cost of capital could be reduced without any subsidy through loan guarantees is based on experience with the U.S. program under Title XI of the U.S. Merchant Marine Act. Under that program, reduced interest rates are obtained for the purchase of ships as a result of government financial guarantees on notes, bonds and bank loans for vessel purchases. A mortgage is placed on the vessel and a fee is charged. The program has been financially self-supporting,[94] which leads to the conclusion that it has worked to remove imperfections in the capital market and not as a subsidy to shipping. The practicality of a comparable scheme deserves attention in Canada.

Conclusions

The opinions of shipowners and shippers differ regarding the question of whether tax and financial measures proposed by marine interests constitute a subsidy to shipping. They are not interested in whether a subsidy is implied according to some general definition of the term; they are concerned with whether the granting of tax and financial measures to deep-sea shipping, which are not generally available, will impose a cost on taxpayers in general and result in resources being shifted from high- to low-productivity investments. The analysis of this chapter suggests that some measures proposed are more likely to have these adverse consequences than others.

Tax deferment on deep-sea earnings through accelerated capital cost allowances and tax-free reserves for vessel replacement would result in only a very small loss of current tax revenue, and only a few resources being diverted into shipping. At the same time, it would make feasible the development of shipping in Canada rather than in other countries. The direct benefits of this would be small at

first but could potentially be significant. Indirect benefits are considered later.

The costs of measures allowing a tax deferment on activities other than deep-sea shipping would be higher than those of the more limited deferment because they would encourage investment in shipping as a means to protect other income from tax. Encouraging resources to be used in relatively low-productivity investments could only be justified if significant non-commercial benefits could be expected for the economy. If that were the case, more direct subsidy measures could be more efficient. However, shipowners as well as shippers are opposed to subsidies, whether open or hidden. Therefore, it appears that only tax deferment measure applied to deep-sea earnings are consistent with the views of shipowners and shippers.

Government measures which reduce the cost of particular resources for shipping should be viewed with caution. Tax concessions for seafarers are not supported by seamen and would encourage an excessive employment of labour. However, a financially self-supporting loan guarantee program deserves to be considered as a means of reducing the cost of capital employed in shipping.

CHAPTER V

THE DARK CLOUDS ARGUMENT

Marine interests support their case for measures to encourage the expansion of Canadian-flag deep-sea shipping with the argument that expansion now would be beneficial to Canadian shippers. Mr. Paul E. Martin explained that -

> The danger is that present trends will eventually lead to conditions in the world shipping market which will cause government to introduce a crash program to develop Canadian flag shipping. In this situation, distortions and inequities, such as would arise with cargo preference measures, would be difficult to avoid. Thus, my position is that shippers as well as shipowners stand to benefit from having Canadian merchant shipping develop gradually and systematically, with a minimal amount of direct government involvement.[95]

This chapter considers the argument that benefits would accrue to Canada from the protection afforded by Canadian-flag shipping against the future restrictive measures of other countries. Most of the chapter examines the changes that have been taking place in the international shipping environment. It also considers how serious a threat possible restrictive measures of other countries - the dark clouds - pose for Canadian interests and what alternate actions could be appropriate as a Canadian response.

The General Environment of Free Competition in International Shipping

As noted in Chapter II, shipowners have been largely free for many years to register ships in any one of many nations and to carry the trade of most countries irrespective of the nationality of the vessels they employ. In the last thirty years these freedoms have been subject to increased challenges. The freedom of shipowners to register their ships in any one of many nations has been challenged at a multi-national level.

In international maritime commerce, the sovereignty of the country whose flag a vessel is entitled to fly is well established in international law. As stated earlier, each State has the right to establish such prerequisites for the assumption of its nationality as its concepts of national welfare dictate. These concepts were laid down in Article 29 adopted by the International Law Commission of the United Nations in 1956.[96] However, the Article also gave rise to the idea that a "genuine link" must exist between the State and the ship. The 1958 United Nations High Seas Convention specifies what constitutes a genuine link:

> There must exist a genuine link between the State and the ship; in particular, the State must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag.[97]

The interpretation of the "genuine link" has given rise to many difficulties as various countries and/or interest groups (such as the International Transport Workers Federation, ITF) have sought to challenge the conditions under which vessels have been registered in so-called flag-of-convenience states.

Some developing countries have sought greater opportunities for their nationals to participate in deep-sea shipping, in particular, by having them serve their country's trades. Their efforts to achieve this have included pressure to ensure some "genuine" economic link between the nation whose flag a vessel flies and the nationality of the shipowners. Carrying the trade for the country whose flag the vessel flies could establish such a link. This policy would greatly restrict the practicality of flag-of-convenience registers such as Liberia.

These pressures have been resisted by flag-of-convenience states (which are developing countries themselves), by traditional maritime states and by countries who give priority to the availability of competitive shipping service over the development of national fleets. They have argued that a "genuine link" requirement is met by the administrative and technical requirements imposed by governments on vessels registered in their countries and does not imply the need for restraints on the economics of operations. Further, they argue that establishing economic constraints on registery would be impractical. An OECD document concluded in 1980 that -

> It appears therefore that it would be almost impossible to cover these economic requirements in terms which could be agreed on or even adequately defined, in an international instrument, and to impose them by political pressure from outside would be unacceptable to a large number of countries. The developed market economy countries have generally taken this view, while at the same time supporting fully the concept of the duties of the flag state which are set out in the draft Law of the Sea text.[98]

The traditional maritime countries may respond to the interests of developing nations in other ways. For example, they may establish joint ventures in shipping. Such responses would address more definitely the concerns of these nations than restrictions on registering ships in the countries of their owner's choice.

Pressures from unions on flag-of-convenience fleets have existed also. They have tried to ensure better standards of employment for crews from less developed countries and to get one crew nationality substituted for another. The efforts of the ITF have probably brought to an end many cases of unreasonable employment conditions on ships. However, it has also become involved in international struggles between unions as one union has attempted to displace another.[99]

Challenges to the freedom of shipowners to register ships in the countries of their choice are likely to continue. However, any significant change in international law governing the registration of ships is unlikely in the foreseeable future. Changes in the competitive nature of international shipping are more likely to arise from restrictions on the ability of ships to participate in trades under multi-national agreements on cargo reservations or other flag discriminatory measures.

Cargo Reservation and the UNCTAD Liner Code

The United Nations Conference on Trade and Development (UNCTAD) was formed to "consider means of accelerating the economic development of less developed states through revised international trade policies."[100] A special committee was formed to investigate the role that shipping could play toward the attainment of this objective. One of the proposals suggested by the committee was the Code of Conduct for Liner Conferences. It was adopted by UNCTAD in April 1974, but has not yet been ratified. The three main objectives of the Code are -

1) to facilitate the orderly expansion of world seaborne trade;

2) to stimulate the development of regular and efficient liner service adequate for the requirements of the trade concerned; and

3) to ensure a balance of interests between suppliers and users of liner shipping services.[101]

One of the most contentious features of the Code is Article 2, which sets out the proposed 40-40-20 rule. It would apportion the carriage of liner cargo in the following manner:

(a) The groups of national shipping lines of each of two countries the foreign trade between which is carried by the conference shall have equal rights to participate in the freight and volume of traffic generated by their mutual foreign trade and carried by the conference;

(b) Third-country shipping lines, if any, shall have the right to acquire a significant part, such as 20 per cent, in the freight and volume of traffic generated by that trade.[102]

The Code provides that if, for one of the countries whose trade is carried, no national shipping lines carry that trade, that country's share of the total shall be distributed among the lines participating in the trade. The Code defines a national shipping line as follows:

A national shipping line of any given country is a vessel-operating carrier which has its head office of management and its effective control in that country and is recognized as such by an appropriate authority of that country or under the law of that country. Lines belonging to and operated by a joint venture involving two or more countries and in whose equity the national interests, public and/or private, of those countries have a substantial share and whose head office of management and whose effective control is in one of those countries can be recognized as a national line by the appropriate authorities of those countries.[103]

The Code does not require that the vessels operated by a national shipping line be registered in that country. Therefore, a Canadian company operating foreign-flag, chartered vessels could be a national shipping line. The interpretation to be placed on "effective control" could be a matter of dispute. This and other issues remain to be resolved. Further, countries acting unilaterally may take more restrictive positions than those included in the Code.

To come into effect, the Code must be ratified by twenty-four countries representing 25 per cent of the world's general cargo and container vessel tonnage. Although more than the required number of countries have ratified the agreement (forty-five countries by March 1980), they do not represent the required vessel tonnage. Nonetheless, the Code has already had a significant influence on the international shipping environment.

New protectionist shipping laws are often justified or supported by reference to the Code. Unilateral actions in Latin American countries, for example, are justified by them on the ground that they are generally in keeping with the principles supported by the Code. As each country assesses its policy regarding the Code, the widening presence of unilateral protectionism makes accession to the Code less costly and/or more beneficial. In part, this may explain the change in position adopted by the countries of the European Economic Community (EEC). However, some countries within the EEC may, also, see ratification of the Code as a means of curtailing the inroads of COMECON shipping (Soviet and other socialist national lines) into their trades.

In May 1979, the EEC members agreed on a uniform approach to the

ratification of the Code in EEC Regulation 954/79 (the "Brussels Package"). Under the Brussels Package, the trade between developed countries (EEC plus those non-EEC OECD countries which are prepared to join the arrangements on the basis of reciprocity) would be treated as a bloc and not subject to the strict nationality requirements of the Code. In the trades between developed and developing countries, the Package provides that the Code should apply but the distribution of the share to be carried by developed country lines will be governed by commercial criteria.[104]

It seems likely, then, that the Code will be ratified and come into force in the next year or so. In addition to the cargo-sharing provisions, countries must consider whether they wish to replace their policies respecting shipping conferences with those incorporated in the Code. Australia, for example, has decided not to accede to the Code because her shippers' interests are protected more effectively with existing legislation.[105] Canada, which abstained from voting on the Code in 1974 and has not ratified it, is still considering her options in the light of the changing international conditions.

While cargo sharing in the Code deals with the liner trade, the developing countries in UNCTAD (the Group of 77) have argued strongly on recent occasions for changes in international arrangements to facilitate their participation in bulk trades. Discussions at the 5th UNCTAD Conference in Manila in May, 1979, showed a strong difference of opinion between the Group of 77 and developed countries. This has been succinctly described by the Department of External Affairs:

> Almost without exception, the developed countries continued to work through the OECD to resist any movement towards either cargo reservation in the bulk trade or the phasing out of open registry fleets (flags of convenience) and, while the developing countries continued actively to promote these goals, little progress has been made by the year's end.[106]

The aim of developing countries to acquire a minimum of 20 per cent of the world deadweight tonnage by the end of the 1980's is a matter that will continue to be contentious. In September 1980, a proposal was before the UNCTAD Committee on Shipping to convene a "Group of Experts to study the problems faced by developing countries in the carriage of bulk cargoes."[107]

Flag Discrimination

Flag discrimination refers to a variety of acts and pressures exerted by government to direct cargoes to ships of their own flags, regardless of the commercial considerations which normally govern the routing of cargoes. Flag discrimination practices fall into five categories: those related to the apportionment of trade, those that affect access to trade, those involving access to port facilities, those affecting trade financing and those indirectly favouring the use of national-flag vessels.

Flag discrimination measures that affect the apportionment of trade include bilateral agreements, the unilateral allocation of cargoes to national-flag carriers, and the requirement that government cargoes be carried in national bottoms. Some countries affect access to trade by excluding foreign ships from competing for certain commodities through the issuance of import licenses. Other regulations with the same effect include rules governing the delivery of cargo (there may be differential rates for inland transportation), cargo-pooling requirements (guaranteeing national carriers a percentage of the traffic), and the imposition of extra duties on imports not using national-flag carriers.

Practices related to port accessibility include discriminatory port charges, and special foreign-flag taxes and dues. Discriminatory prices may also exist for the use of port facilities and services such as harbour, lighthouse and pilotage services. National-flag vessels may also enjoy preferential berthing assignments and customs clearance.

Practices concerning trade finance include provisions that extend insurance concessions to national-flag vessels, currency restrictions and exchange controls, special tax concessions for national shipping companies, and special tax inducements to use national-flag vessels.

Government pressure rather than direct regulation is also used. In some states (Columbia, South Korea, Thailand and Taiwan), exports are supposed to be shipped in national vessels on a c.i.f. basis, while imports are handled on a f.o.b. basis. This ensures that domestically incorporated businesses control the routing of cargo. Another indirect measure is the establishment of a government agency to control cargo routing and transportation.

Flag discrimination practices are widespread in developing countries. The practices of Venezuela and Colombia have had the most significant impact on Canadian trade. Diplomatic intervention by the Federal Government with Venezuela was necessary for Saguenay Shipping Limited to become the Canadian carrier designated to participate in the trade. This development added to the appropriateness of Canadian-flag vessels for Saguenay. On the west coast, Westfal-Larsen had problems of access to Canadian cargoes destined for Colombia. This experience led the Norwegian parent company to establish Canadian Westfal-Larsen Ltd., which has headquarters in Vancouver.

Flag discrimination is practiced by some countries seeking to develop a national marine. These include countries in which the shipping is state-owned. An increase in the size of these fleets raises particular questions for Canada's shipping policy.

The Rise of State-Owned Fleets

The expansion of state-owned fleets has been most rapid for the countries of the Council of Mutual Economic Assistance (COMECON) alliance and for the developing nations. The growth of both fleets is

viewed with concern because it is associated with cargo preference practices. However, the growth of the COMECON fleet gives rise to additional concerns.

The COMECON countries are Bulgaria, Romania, Hungary, Czechoslovakia, Poland, the USSR and East Germany. Of these, the USSR fleet has grown most substantially. Between 1965 and 1979 the tonnage of the Soviet fleet increased 2.8 times to reach 22.9 million gross registered tons in 1979. Although the Soviet fleet has traditionally been heavily committed to domestic trades, in 1978 about two thirds of the cargo tonnage carried was in foreign trade.[108]

The expansion of the Soviet liner fleet has been viewed, particularly by EEC members, as a serious threat to the stability of commercial lines.[109] Concern in the U.S. resulted in the passage of the Ocean Shipping Act, 1980, the so-called, "controlled-carrier bill". The concerns have been stimulated by the perception that Soviet competitive practices were subsidized by the State and would, thereby, undermine the viability of commercially-based lines. Further, it has been felt that dependence on Soviet services for a significant portion of the transportation of foreign trade would create an undue dependence on a service that might be withdrawn for political rather than economic reasons.

The absence of Canadian-flag conference lines has resulted in few concerns about the competitive impact of Soviet shipping in Canada. Indeed, as long as the competitive practices are not uneconomic when service and rate levels are considered, Canada's trade interests would be served well by the competitive influence of Soviet lines. However, dependence on Soviet services would increase the risk of a service being withdrawn for political reasons. Therefore, the level of participation of Soviet shipping in Canadian trade deserves attention.

In 1976, COMECON vessels carried 3.9 per cent and 2.3 per cent of the weight of overseas waterborne exports and imports, respectively. Soviet vessels, alone, accounted for 2.8 and 1.3 per cent, respectively. The dominant trade flows were grain to the USSR, Eastern Europe and Cuba, high-valued cargo from the USSR and Europe, and the carriage of some cargoes to third countries.[110] In the trade with the COMECON countries, significant proportions of the trade are carried in COMECON vessels. In 1976, about 40 per cent of exports to the USSR and the Eastern Europe, as much as 94 per cent of imports from the USSR. However, the latter trade volume was small (142,000 tons). COMECON vessels continue to be major carriers of Canadian trade only in the trades with COMECON countries.

From a Canadian perspective, then, the development of state-backed fleets does not pose a significant threat to the stability of available shipping services. The direct impact of international political events on trade volumes and patterns is of much more importance than the potentially disruptive effects of changes in the level of service offered by state-backed fleets for political reasons.

Implications for Canadian Shipping Policy

In the period since World War II, increased pressures have been exerted to reduce the freedoms enjoyed by shipowners. The traditional laissez-faire environment of shipping has been eroded slowly by various unilateral, bilateral and multi-national arrangements. So far, these arrangements have only posed minor and specific problems in Canadian trades. Shippers believe that this will continue to be the case. They do not believe that flags of convenience will cease to exist. The position of state-owned fleets in Canadian trade is not seen as a general problem. Shippers point out that flag discrimination and even cargo reservation under the principles of the UNCTAD Liner Code (if applied within the bloc concept of the EEC) would affect only a small part of Canadian trade. Shippers argue that because the problems will arise in particular trades in particular ways and at uncertain times, the Canadian Government should respond by continuing to support strongly the maintenance of competitive conditions in international shipping and by increasing its ability to respond quickly and effectively to measures introduced by other governments which reduce the competitiveness of shipping services available to Canadian trades. Shippers do not believe that the threat of restrictive measures by other governments warrants the provision of tax and financial measures for Canadian shipping operations that "fail to achieve cost competitiveness with foreign operators."[111]

Shipowners argue that the views of shippers are "at best, short sighted"[112] and ignore the radical changes that are taking place in international shipping. They believe that, sooner or later, these changes will necessitate the development of Canadian shipping.

Shippers and shipowners continue to disagree about the implications of the changing environment for Canadian shipping policy for two reasons. First, their perceptions differ regarding the long-run implications of the changing environment in international shipping, even though they are both knowledgeable about the international shipping market. Second, shipowners have not shown how the dark clouds argument is relevant to the tax and financial measures they propose. They present it as one of the reasons for these measures being desirable. But it is unclear whether the dark clouds argument is a reason for subsidizing the development of Canadian-flag shipping.

Little can be done here to resolve the dispute about the significance of long-run developments of international shipping. However, the author's opinion is similar to that of shippers. Since the principles of ship registration are well established in international law, changes are likely to be limited and slow. Developments in cargo sharing and reservation are likely to be applicable to specific and minor Canadian trades. It is appropriate to conclude that reliance on intergovernmental negotiation, on a case-by-case basis is appropriate to the nature and magnitude of the problem.

The relevance of the dark clouds argument to the case for financial and tax measures can be clarified. The case for a loan guarantee program should rest on its being self-financing, as discussed in Chapter IV. The case for tax measures should be unaffected by the dark clouds argument if capital is to be used efficiently and if subsidies to shipowners are to be avoided (the position adopted by shipowners).

The relevance of the dark clouds argument to tax measures is less straightforward. Tax deferral measures can potentially impose costs on the Canadian economy as resources are transferred into shipping and potentially bring benefits as shipping is repatriated. The costs are more likely to exceed the benefits when the deferral of taxes is allowed to apply beyond earnings from deep-sea operations, since this would induce more resources to be employed in shipping than would otherwise be the case. As these costs become larger, the the dark clouds argument is more essential to the case that benefits exceed the costs. That is, it would have to be shown that using tax deferral measures for encouraging Canadian-flag deep-sea shipping would be a cost-effective way of dealing with problems that might arise from the intervention of foreign governments.

The presence of Canadian-flag shipping could conceivably add to Canada's bargaining position when faced with unfavourable unilateral decisions by foreign governments. However, there is no guarantee that the type of shipping developed in response to favourable tax measures would be relevant to the trade in which such an intervention might occur. Tax measures have general effects; foreign government interventions are time-and route-specific. The prospect of foreign government intervention requiring the presence of Canadian-flag ships is uncertain and appears to be restricted to minor trades.

So far, intervention has been dealt with by the Canadian Government less expeditiously than shippers would have liked, but the end results appear to be as good as could be expected. Cargo sharing arrangements required by other governments protect markets from the full impact of international competition and can be favourable to the development of Canadian-based services as evidenced by the services of Saguenay Shipping Limited and Canadian Westfal-Larsen Ltd. (Only two of the vessels in these services are registered in Canada, but the companies provide services beneficial to Canadian trade requirements.)

CHAPTER VI

BALANCE OF PAYMENTS AND EMPLOYMENT EFFECTS OF SHIPPING

Proponents of Canadian deep-sea shipping have frequently supported their position by reference to the benefits such shipping would have on the national balance of payments and on employment opportunities. This chapter examines whether Canada would realize such benefits from an increase in Canadian-flag deep-sea shipping. The implications of the conclusions for the provision of accelerated capital cost allowances to shipping are presented at the end of the chapter.

The Balance of Payments

Shipping has been promoted as a source of foreign exchange and as a means of moderating Canada's adverse balance of payments in its services and financial capital flows (the invisibles accounts).[113] In this context, reference is made to the substantial expense incurred by Canadians in the purchase of foreign flag shipping services. Shipowners, in their recent statements, however, have not emphasized the merits of shipping as a source of foreign exchange. There are good reasons for this.

First, the effects of Canadian-flag shipping on the direct net exchange position are not great. Under foreign-flag operations, some expenses are incurred in Canada, while under Canadian-flag operations, many expenses would be incurred abroad. In particular, vessels would most likely be purchased abroad. In 1980, Mr. H.E. Bell, Vice President of Federal Commerce and Navigation, suggested "that there will not be any significant effect on balance of payments, and that care should be taken in making general statements..."[114]

Second, the merit of balance-of-payments arguments to justify government intervention is frequently exaggerated. Often, too little attention is given to "the proper question [which] is: what is the net extent to which the balance of payments differs from what it would

have been if [intervention] had not taken place?"[115] The implications of this question are far-reaching. What would be the alternative employment of resources if they were not diverted by government intervention to an "export" industry? They might well be employed in a domestic industry which has substantial import-substitution effects. Thus, estimating the true net impact that government intervention might have on the balance of payments is difficult. The appropriate policy might be simply to promote efficient industries, whatever their markets, rather than focussing on export industries.

Third, insufficient attention is generally given to the value of foreign currency to the economy. Is an American dollar worth more than the Canadian equivalent obtained from the exchange rate and, if so, why and by how much? It is only worth more or less to the extent that the going exchange rate does not reflect the real relative productivity of resources in the two countries. During 1980 and 1981, government intervention was used to hold up the value of the Canadian dollar; that means that expenses have been incurred to maintain an "artificial" rate. In real terms, each American dollar earned has been worth more than the exchange rate equivalent. By how much? Economists place various net values on foreign currency. Some argue that, except when exchange rates are fixed or government interferes with floating rates, no premium should be accorded to foreign currency. Others argue that the net long-run value of foreign currency to Canada is up to 15 per cent higher than the exchange rate because of the general effect of trade barriers. If this latter figure is accepted, then for every dollar of taxpayers' money devoted by government intervention to improving the balance of payments, the net additional foreign currency earned must exceed a value of $6.67 Canadian. Only then would the dollar invested yield a positive balance of payments benefit ($6.67 times 0.15 equals $1.00).

The small net impact on foreign exchange earnings, the delay in those effects because of ship acquisition costs and the small (and uncertain) value of foreign currency beyond its market exchange rate, all suggest that little value would be gained for the economy from deliberately diverting resources into Canadian-flag shipping. The limited significance attached by shipowners to the balance of payments benefits derived from Canadian-flag shipping seems appropriate.

Employment Opportunities

Government intervention in the economy might be justified if it would result in employment for Canadians otherwise unemployed. Some argue that, from a national viewpoint, the wage paid to employ a person is not the true cost to society because the person would not otherwise be producing goods and services and, in addition, a period of unemployment might reduce his long-run productivity. Therefore, direct government employment or subsidies to firms employing persons otherwise unemployed might be warranted.

For shipping to reduce unemployment, the industry must draw upon a pool of labour characterized by a significant and long-run level of

unemployment. It is necessary, then, to consider the requirements of and supply of labour for shipping.

The development of Canadian-flag deep-sea shipping has been made conceivable, in part, by the reduction in crew sizes achieved in recent years. A bulk carrier of 50,000 dwt may well operate with a crew of 20 to 24. The number employed would be larger to allow for crew leave and sickness, etc. Thirty to forty-eight men would probably fill total manning requirements.[116]

The supply of qualified licensed personnel for deep-sea operations is inadequate, in part, because of the current lack of opportunities to gain the necessary qualifications on Canadian vessels. (Some Canadians who seek training and experience in deep-sea employment leave the country.) Consequently, an increase in deep-sea operations would require the use of immigrants, generally British. In the short run, then, the requirement for officers would be met by immigration, and longer-term needs would be met by improved training and sea-going opportunities.

The supply of unlicensed personnel is likely to be sufficient in number although upgrading skills through training will be important. The fact that marine employment is particularly heavy in parts of the Maritimes and Quebec where unemployment rates are high, means that increasing employment opportunities for seamen could be expected to result in work for some persons otherwise unemployed. It is difficult to estimate the number of persons who would be employed and the value of this to the economy. But, because a Canadian merchant marine is expected to develop gradually, the number of additional persons employed in the economy would likely be small. If an additional twenty persons per vessel gained employment, five ships would produce employment benefits of $1 million, assuming the value of $10,000 per job.

Maritime unions anticipate substantial gains in employment from the development of shipping. But, they do not differentiate between levels of employment associated with particular tax measures and those associated with Arctic shipping services or land-based supply employment. In this analysis, the general matter of tax measures and the specific issue of Arctic shipping should be kept separate. Excluding the Arctic shipping services, the total number of persons, otherwise unemployed, who would be employed as unlicensed seamen because of an expansion of deep-sea shipping would be small. Probably some, but not substantial, employment benefits would be realized from ship service activities.

The conclusion that some employment benefits will be gained from expanding Canadian flag deep-sea shipping assumes that persons otherwise unemployed will find deep-sea shipping employment attractive. The difference in the way of life in deep-sea shipping compared to coastal or Great Lakes shipping leaves that assumption untested.

Employment benefits are best treated as a positive externality (a bonus) of encouraging Canadian-flag deep-sea shipping to expand through the deferral of tax on deep-sea earnings. A case cannot be made for promoting shipping beyond that level on the basis of job creation because shipping is such a capital-intensive industry. Furthermore, creating additional employment in ship service activities would be more efficiently dealt with directly than through subsidies to shipping.

Conclusion

Net foreign exchange earnings in the long run are implicit from a profitable and competitive shipping industry. However, the acquisition of ships abroad would delay this effect for several years; and then the value of the earnings, beyond that represented in the exchange rate, would probably be small. Thus, the effects of Canadian-flag shipping on the balance of payments would not be sufficient to justify the introduction of tax deferral measures to encourage the development of Canadian-flag shipping.

The development of Canadian international deep-sea shipping would be associated with some gains in employment. These could be significant in relation to the limited costs associated with tax deferral measures applicable to international deep-sea earnings. However, the employment benefits derived from capital-intensive shipping would be insufficient to make economic measures to allow the capital cost allowance on international deep-sea ships to be applied against income from other activities.

CHAPTER VII

THE CASE OF ARCTIC SHIPPING

In the discussion of shipping policy, the Arctic should be treated separately. This is not always done, so promotional arguments relevant to the Arctic become applied to all shipping. This chapter attempts to set out some of the issues related to an Arctic shipping policy; it does not attempt to reach any conclusions.

Sovereignty

The exercise of national sovereignty is sometimes raised as a reason for promoting economic development in a formerly undeveloped region. Often, and probably rightly so, this emotive appeal carries little weight when national sovereignty over a region is not threatened. However, in the Canadian Arctic, the power of the Government of Canada to establish regulations protecting Canadian interests is in some doubt. For example, the right of Canada to protect the environment unilaterally through the Arctic Waters Pollution Prevention Act is disputed. Thus, the extent of Canadian presence in the Arctic may be important to establishing national sovereignty.

Environmental Protection

Environmental protection is a special issue in the Arctic because of its distinctive, highly sensitive ecology and the limited knowledge about shipping technology in Arctic waters. These conditions give rise to two questions. First, how far can cost-effective standards for vessel design and operation be set without a Canadian presence in operations? Second, how far can regulations be relied on to provide an adequate level of protection over the actions of foreign firms? The presence of Canadian commercial vessels might be desirable in the Arctic for environmental reasons, even if this operation has to be subsidized.

The Infant Industry Argument in Industrial Strategy

Although Canada extends into the Arctic, it has been slow to develop ice-related technologies. In view of the current and prospective Arctic developments, serious questions exist about these technologies. One of the industries affected is shipping. Is ice-strengthened shipping an 'infant industry'; that is, is it one which, if given assistance initially, would develop a comparative advantage over other maritime nations? If so, special measures may be appropriate to assist the development of Arctic shipping.

Transport Costs and Resource Development in Frontier Regions

The Government has recognised that special considerations apply to Arctic shipping. A Shipping Policy for Canada (1979) stated -

> With respect to Arctic shipping, the Government intends that, as a condition of approval to export unprocessed or partially processed resources, Canadian registered vessels must be used if they are available at reasonable cost. The Government is also prepared to consider, on their merits and on an ad hoc basis, substantiated requests for assistance related to the use of ships both registered and built in Canada for use in the Arctic.[117]

The statement recognises implicitly that the level of transport cost is important to the profitability and even viability of resource projects in the Arctic. This is a general feature of resource projects in remote locations and is not unique to the Arctic.

Policy Implications for Arctic Shipping

The problem of deciding whether Canada's interests are served best by free trade or by protectionist policies is the same for Arctic shipping as for other shipping services. Canada has benefited from and promotes the principle of free trade. As a trading nation, the country is hurt by the restrictive trade policies of other countries whether they are retaliatory or not. Therefore, unless private and national interests diverge significantly, Canada is served best by allowing resources to be allocated where they produce their highest commercial return. That includes the purchase of goods and services on the most advantageous terms whether from a Canadian or foreign source. However, in the case of the Arctic, the issues raised by sovereignty, environmental protection and industrial strategy make it appropriate to consider Arctic shipping as a special case. The provision of accelerated capital cost allowances and investment guarantees would make Canadian-flag-shipping more practical in the Arctic as well as other trades. These measures might obviate the need for other forms of protection or assistance for Arctic shipping.

CHAPTER VIII

SUMMARY OF CONCLUSIONS

This study has reviewed the position of the major groups interested in Canadian shipping policy and has analysed the case for tax and financial measures designed to support the development of Canadian-flag shipping in international deep-sea trades. This chapter presents the conclusions of the analysis and outlines the issues which appear to be important to the adoption of a policy by the current Government.

Arctic Shipping

The Canadian policy on international shipping to and from the Arctic should be evaluated separately from the policy for other deep-sea services because of certain unique conditions affecting Arctic shipping. This is not always done. The separate treatment of Arctic shipping should enable clarification of the probable effect on employment of measures to develop shipping. Government policies designed to develop a Canadian Arctic shipping technology might have considerable direct effects on shore-based employment. However, this is not likely to be the effect of measures to encourage Canadian-flag deep-sea shipping in general.

The unique conditions of sovereignty, environmental protection and the economic potential of ice-related shipping technology are not considered in depth in this paper. Therefore, no conclusions are offered on Arctic shipping policy.

The Loan Guarantee Program

The cost of capital is important because ships are highly capital intensive. Reducing the cost of capital by subsidies is not desirable because it would result in an excessive employment of capital in ships. However, loan guarantee programs in other countries should be studied to assess the probability that one could be self-financing in

Canada.

Tax Measures and the Development of Canadian-Flag Shipping

Shipowners have recommended tax deferral measures for firms providing Canadian-flag deep-sea shipping. These measures were analysed in Chapter IV. The conclusion of that analysis is that when accelerated capital cost allowances are applied only to international deep-sea earnings, the potential cost is small. (The rate at which a Canadian-flag deep-sea fleet would grow would be slow, but that is consistent with the labour supply conditions.) Firms would not be induced to divert resources that could be used elsewhere into deep-sea shipping. However, the main effect would be to remove the tax incentive for Canadian firms to operate foreign-flag ships through foreign subsidiaries. The management of Canadian-flag ships in Canada would provide personal taxes to offset the deferral of those corporate taxes (if any) now paid on international deep-sea earnings and encourage the development in Canada of expertise beneficial to the profitable conduct of trade and shipping.

Theoretical research can contribute little to estimate the rate at which Canadian-owned shipping, which would otherwise be registered and managed abroad, would be registered and managed in Canada. Critical to this are the labour/management relations which would evolve in the Canadian industry. The cost and productivity of Canadians and the conditions under which non-Canadians could be employed would be important. If labour or other resource costs in Canada prove to be too high for the development of shipping competitive in international markets, very little, if any, cost would have been incurred in creating a policy environment in Canada consistent with that well-established in many other countries and necessary for the operation of international shipping.

If international deep-sea shipping expands under the policy, it would result primarily from the operation of shipping under Canadian rather than foreign-registry; it would not result from the diversion of resources into international deep-sea shipping from other uses. If this analysis is correct, the probability is high that the benefits would exceed the costs.

Possible benefits from the effects of international deep-sea shipping on the balance of payments, unemployment and government policy options in the face of intervention by other governments in international shipping are concluded to be small. They enhance the case for accelerated capital cost allowance measures applicable to international deep-sea earnings, but they do not appear to be sufficiently substantial to warrant allowing them to be applied to other earnings. The latter policy would result in a greater deferral of taxes and the diversion of resources into nationally less-productive investments.

The tax measures applied to international deep-sea shipping will affect the practicality of unsubsidized and competitive services being

provided by Canadian firms into the Arctic. Without tax deferral measures, Canadian firms would be at a competitive disadvantage and would likely require some preferential treatment or other subsidy to be able to operate profitably. To the extent that special benefits might be attributable to Canadian participation in Arctic shipping, the case for tax deferral measures is enhanced.

The Freedom of Corporate Choice

Shippers have expressed concern, not only about the impact of alternate tax and finance measures on taxes and the productivity of resource employment, but also about the long-run implications of the development of Canadian shipping for their freedom of choice. They are concerned that Government action to encourage Canadian shipping will precede Government action to pressure or force some Canadian trade to be carried in Canadian-flag ships, even though the services may be less attractive to the shippers. They fear that such measures may turn out to be 'the thin edge of the wedge'.

Shipowners have agreed with shippers that preservation of shipper freedom of choice between shipping services is an important component of Canadian shipping policy. It has been acknowledged as important in Government policy statements. Nevertheless, the fear persists with many shippers. References by shipowners and the government that certain foreign-aid and commercial cargoes, for example, from the Arctic, be designated for Canadian-registered ships aggravate shippers' concerns. (If Canadian ships are used for the carriage of aid cargoes although their costs are higher than those of foreign vessels, the result of the protection would be less real aid or the same aid at higher cost to the taxpayer.)

Shippers fear that some form of protection for Canadian-flag shipping could be sought by shipowners and/or maritime unions if Canadian-flag shipping, developed under tax incentive measures, turns out to be unprofitable. The scale on which Canadian-flag shipping would develop is important to these concerns. A rapid and substantial development might lead to some significant pressures for Government protection for Canadian-flag shipping should the ships turn out to be uncompetitive. However, the limited and gradual development of Canadian shipping envisaged in this report is not likely to give rise to such pressures. The risk that shipowners would seek Government protection might be viewed as less than comparable action by any Canadian industry faced with international competition because of the explicit basis on which the policy would be based. Shipowners are on record as being opposed to such protection.

Some shippers fear that the presence of certain Canadian-flag ships in international deep-sea trades will produce union pressures for an extension of the use of Canadian vessels. This may be a concern of shipowners too, particularly those who might own both Canadian and foreign-flag vessels. But pressure from unions would be unlikely in view of the expected shortage of Canadian seafarers if Canadian deep-sea shipping were to develop. The justification for

such union pressures is hard to anticipate. Nevertheless, the concern of some shippers and shipowners exists.

The concerns about possible restrictions on the freedom of corporate choice appear very important, especially to shippers. Shippers feel that worthwhile guarantees cannot be provided about the future behaviour of corporate executives, union leaders or government leaders. However, this is a problem not peculiar to shipping!

The Development of a Deep-Sea Shipping Policy

The diversity of interest groups affected by Canadian shipping policy makes complete agreement on a policy unlikely. Whether shippers will view the effects of accelerated capital cost allowances applicable only to international deep-sea earnings as detrimental to their interests is not known. It is probable that not all shipping firms will consider them in equal light as changes in tax measures are predictably more favourable to some firms than others. Maritime unions might prefer a policy that would lead to more rapid increases in marine employment opportunities.

Progress in the development of a deep-sea shipping policy is dependent on examining the nature and effects of specific tax and financial measures for shipping. However, the measures have both economic and behavioural implications so that the end results cannot be forecasted with certainty. Consequently, further discussions between the parties and with Government may be necessary.

FOOTNOTES

1. Transport Canada, A Shipping Policy for Canada (Ottawa: Minister of Supply and Services, 1979).

2. Ibid., p. 51.

3. Transport Canada, Background Paper on Deep-Sea Shipping, Transport Canada, Shipping and Policy Branch, October, 1979.

4. Ibid., p. 40.

5. See Boleslaw A. Boczek, Flags of Convenience: An International Legal Study (Cambridge, Mass: Harvard University Press, 1962).

6. OECD, Maritime Transport, 1979 (Paris: OECD, 1980), p. 68.

7. Note 1 of the OECD Invisibles Code states: "As the shipping policy of the Governments of the Members is based on the principle of free circulation of shipping in international trade in free and fair competition, it follows that the freedom transactions and transfers in connection with maritime transport should not be hampered by measures in the field of exchange control, by legislative provisions in favour of the national flag, by arrangements made by governmental or semi-governmental organizations giving preferential treatment to national flag ships, by preferential shipping clauses in trade agreements, by the operation of import and export licensing systems so as to influence the flag of the carrying ship, or by discriminatory port regulations or taxation measures the aim always being that liberal and competitive commercial and shipping practices and procedures should be followed in international trade and normal commercial considerations should alone determine the method and flag of shipment."

8. A.W. Currie, Canadian Transportation Economics (Toronto: University of Toronto Press, 1967), p. 617.

9. Ibid., pp. 618-620.

10. For a history of the West Indian service of CNS see F. Harrington, The Lady Boats, (Halifax: Canadian Marine Transportation Centre, Dalhousie University, 1980).

11. Currie, op. cit. p. 623.

12. A Shipping Policy for Canada, op. cit. p. 7.

13. H.J. Darling and G.C. Shaw, "A Review of Canadian Lake Shipping on the Great Lakes," Marine Transportation Policy Project, Final Report (Toronto: Toronto/York University Joint Program in Transportation, Research Report No. 48, 1978), pp. 63-110.

14. "Shipping group thinks Canada well served by foreign lines," The Globe and Mail, April 24, 1975.

15. "Huge Eurocanadian bulk deal," Seatrade, November, 1980; "Casting out the navy blues", Macleans, December 19, 1980.

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17. "Shipowner is critical over federal policy," The Globe and Mail, May 3, 1974.

18. K.C. Griffin, "Canada's Duep Sea Fleet is Hidden Offshore," Seaports and Shipping World, February, 1979, pp. 23-31; and K.C. Griffin, "Composition of the Canadian Deep Sea Fleet 1980", Unpublished, 1981.

    Determination of the beneficial owenership of ships is notoriously difficult. It is complicated by the speed with which ownership can change. Mr. Griffins' data should be viewed as extraordinarly good data generated by a single researcher. However, like data compiled by research organizations, it cannot be expected to be without error or some debatable judgements.

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21. "Fedcom only regular liner service on Lakes," The Globe and Mail, March 8, 1979.

22. "Upper Lakes Shipping orders first new deep-sea vessels with fuel-miser hull," The Globe and Mail, October 25, 1979. For a detailed evaluation of the employment of Canadian-registered vessels in both Great Lakes and ocean trades, Gordon C. Shaw, The Market Potential for Canadian-Registered Vessels Capable of Carrying Both Great Lakes and Ocean Cargoes, Canadian Transport Commission, Research Branch, Report No. 30-81-05, April 1981.

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114. H.E. Bell, "Financing Considerations in Determining Owners' Choice of Flag," Third National Marine Conference, op. cit. p. 106.

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116. The SIU contract with Hall Corporation provides for ten days of leave for each thirty days worked. Some European operators approach a 2/1 ratio of manpower to crew.

117. A Shipping Policy for Canada, op. cit. p. 51.

Appendix I

Statement of a Shipping Policy for Canada, 1979*

The Government has concluded that the primary objective of Canadian deep-sea shipping policy should be to ensure the continuing availability of adequate and economic shipping services as part of the overall transportation system serving Canada, with a secondary objective of being able to capitalize on significant opportunities.

After full consideration of all of the factors involved, the Government has concluded that, in the present circumstances achievement of these objectives does not warrant the provision of new tax or financial measures to support the development of a Canadian deep-sea merchant marine. In reaching this decision, which will be reviewed in the light of changing circumstances, the Government took into account the current depressed conditions in deep-sea shipping, the fact that Canada continues to receive adequate levels of service from foreign flag operators, and the economic implications of a diversion of scarce national resources into deep-sea shipping.

The Government has, however, also concluded that a number of related measures are necessary if Canada is to continue to rely on the forces of the international marketplace to supply most deep-sea shipping requirements, and if foreign flag vessels are to continue to play a primary role in the carriage of Canadian trade. It is this element of the suggested policy that sets it apart from the approach taken by Canada since the late 1940s. Whereas the latter was essentially passive with no Government involvement, the new approach implies a more direct and active Government interest in deep-sea shipping matters, and envisages a number of measures to ensure that competitive market conditions are not unduly constrained and that our national interests are both promoted and protected.

Such measures will include continued support for competitive conditions in international shipping as the most desirable means of ensuring adequate and economic shipping services. In the absence of any major changes in the current situation, this approach will also imply resistance to any proposals that would deny Canada access to commercial shipping services from any particular country or group of countries. Close monitoring by the Government of the extent, nature and impact of foreign flag participation in Canada's external trade and of technological developments will be required to ensure a quick response should Canadian interests be adversely affected or favourable opportunities arise.

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*Source: Transport Canada, Marine, A Shipping Policy for Canada (Ottawa: Minister of Supply and Services, 1979), p. 51.

The Government intends to proceed with legislation to give it broad powers to obtain information and to act where Canadian shipping interests are threatened by the actions of a foreign Government or carrier. Legislation would include the power to permit the designation of "Canadian shipping lines", including companies located in Canada but not operating vessels under Canadian registry, to enable the Government to respond to the requirements of a number of developing countries. It will also provide for the possibility of shipping agreements with one or more countries to ensure that a Canadian company is able to participate in trades from which it otherwise would be excluded by the actions or policies of other Governments.

The Government intends to assess the possibilities for Canadian flag participation in the shipment from Canada of aid and certain commercial cargoes. With respect to Arctic Shipping, the Government intends that, as a condition of approval to export unprocessed or partially processed resources, Canadian registered vessels must be used if they are available at reasonable cost. The Government is also prepared to consider, on their merits and on an ad hoc basis, substantiated requests for assistance related to the use of ships both registered and built in Canada for use in the Arctic.

The Government is of the view that the measures outlined above represent an appropriate framework for Canadian deep-sea shipping policy, and it is the intention to implement the various elements of the policy over the months to come. The policy framework, and the individual elements of it, will of course be subject to review as and when circumstances change, either in Canada or internationally.